INFLATION REPORT / JANUARY

2005

CNB CZECH NATIONAL BANK

INFLATION REPORT / JANUARY

CNB CZECH NATIONAL BANK

CONTENTS

TABLES IN THE TEXT 2
CHARTS IN THE TEXT 3
BOXES AND ANNEXES CONTAINED IN PAST INFLATION REPORTS 5
ABBREVIATIONS USED 6
FOREWORD 7
I. SUMMARY 8
II. INFLATION DEVELOPMENTS 10
II.1. PAST INFLATION DEVELOPMENTS 10
II.2. FULFILMENT OF THE INFLATION TARGET 12
III. INFLATION FACTORS 14
III.1. THE EXTERNAL ENVIRONMENT 14
III.2. INTEREST RATES AND THE EXCHANGE RATE 15
III.2.1. The interest rate component of the monetary conditions 16
III.2.2. The exchange rate 17
III.3. THE BALANCE OF PAYMENTS 17
III.3.1. The current account 18
III.3.2. The financial account 19
III.4. MONEY AND CREDIT 20
III.4.1. Money 20
III.4.2. Credit 21
Box: The structure of lending 22
III.5. DEMAND AND OUTPUT 24
III.5.1. Domestic demand 24
III.5.2. Net external demand 26
III.5.3. Output 27
III.5.4. Financial performance of non-financial organisations and corporations 28
III.6. THE LABOUR MARKET 29
III.6.1. Employment and unemployment 29
III.6.2. Wages and productivity 30
III.7. IMPORT PRICES AND PRODUCER PRICES 31
III.7.1. Import prices 32
III.7.2. Producer prices 33
IV. THE MACROECONOMIC FORECAST AND ITS ASSUMPTIONS 36
IV.1. EXTERNAL ASSUMPTIONS OF THE FORECAST 36
IV.2. INTERNAL ASSUMPTIONS OF THE FORECAST 36
Box: Uncertainty regarding the evolution of public finances in 2005 and 2006 36
IV.3. THE MESSAGE OF THE FORECAST 38
IV.4. EXPECTATIONS OF ECONOMIC AGENTS 40
Box: Inflation expectations in the CNB's modelling system 41
ANNEX 42
ASSESSMENT OF THE FULFILMENT OF THE MAASTRICHT CONVERGENCE CRITERIA AND THE DEGREE OF ALIGNMENT OF THE CZECH ECONOMY WITH THE EURO AREA 42
MINUTES OF THE CNB BANK BOARD MEETINGS 57
MINUTES OF THE BOARD MEETING ON 27 OCTOBER 2004 57
MINUTES OF THE BOARD MEETING ON 25 NOVEMBER 2004 59
MINUTES OF THE BOARD MEETING ON 22 DECEMBER 2004 61
ANNEX OF STATISTICAL TABLES 63

TABLES IN THE TEXT

Table I.1.	Inflation fell in the last two months of 2004 Q4	8
Table II.1.	Food prices contributed most to the decline in annual inflation in 2004 Q4	10
Table II.2.	Headline inflation at the end of 2004 was almost in line with the July 2003 forecast	12
Table II.3.	External demand developed broadly in line with the July 2003 forecast's assumptions	13
Table II.4.	The revision of the GDP figures led to a revision of the output gap towards greater closure	13
Table III.1.	The current account deficit increased, owing to growth in non-residents' profits	18
Table III.2.	Annual M2 growth slowed in 2004 H2	20
Table III.3.	The upturn in lending to non-financial corporations continued	21
Table III.4.	Credit was the biggest growth item of corporate external funds	22
Table III.5.	The rate of growth of loans to households remained high, with housing loans still predominating	22
Table III.6.	The contribution of the fast-growing investment demand to GDP growth in 2004 Q3 was greater than that of consumer demand	24
Table III.7.	High profit growth was achieved in the first three quarters of 2004	28
Table III.8.	A higher material cost-output ratio year on year was offset by a falling personnel cost-output ratio	28
Table III.9.	The renewed growth in labour demand was visible in industrial branches enjoying stronger demand for their output	29
Table III.10.	Annual nominal and real wage growth picked up in 2004 Q3	30
Table III.11.	Import prices remained strongly affected by fast-rising prices of crude materials and mineral fuels on world markets	32
Table IV.1.	The price of Ural crude oil is expected to fall	36
Table IV.2.	Real disposable income growth will slow in 2006	39
Table IV.3.	Economic growth will be driven by exports and investment	39
Table IV.4.	Growth of adjusted inflation excluding fuels will be the main driving force behind rising inflation	40
Table IV.5.	The inflation expectations of economic agents were consistent with the CNB's target	40

CHARTS IN THE TEXT

Chart I.1. Inflation continued fluctuating near the centre of the target band in 2004 Q4 8
Chart I.2. The centre of the inflation forecast is slightly below the point inflation target at the monetary policy horizon 9
Chart II.1. Annual inflation declined in 2004 Q4 10
Chart II.2. Owing to higher regulated price inflation and lower market price inflation, the share of regulated prices in annual consumer price inflation was higher in 2004 Q4 11
Chart II.3. A change in the agricultural producer price trend fostered slower growth of food prices 11
Chart II.4. Fuels remained the market commodity with the fastest-rising prices 11
Chart II.5. The impact of rising oil prices on consumer prices of fuels was dampened by several factors 12
Chart II.6. Consumer price inflation in the Czech Republic remained higher than in the EU Member States in 2004 Q4 12
Chart III.1. Oil prices were a source of uncertainty throughout the period 14
Chart III.2. The dollar started to plunge in value in May 2004 14
Chart III.3. Economic growth in the "old" EU Member States slowed in 2004 Q3 15
Chart III.4. GDP rose much faster in the "new" EU Member States than in the euro area 15
Chart III.5. The CNB left key interest rates unchanged 16
Chart III.6. Market interest rates declined 16
Chart III.7. The interest rate differentials decreased 16
Chart III.8. Ex ante real interest rates were mostly flat 17
Chart III.9. The koruna appreciated against both the euro and the dollar in 2004 Q4 17
Chart III.10. The nominal effective exchange rate appreciated year on year in 2004 Q4 17
Chart III.11. The trade deficit decreased significantly in 2004 Q3 18
Chart III.12. The income deficit increased significantly in 2004 Q3 18
Chart III.13. Slovakia became the largest foreign investor 19
Chart III.14. The net inflow of portfolio investment decreased somewhat in Q3 19
Chart III.15. The international reserves increased in dollar terms in 2004 Q4 20
Chart III.16. M2 growth was in line with GDP growth 21
Chart III.17. Despite increasing, the spread between the interest rate on loans to non-financial corporations with maturities up to 1Y and the 1Y PRIBOR remained relatively low 21
Chart III.18. The importance of loans in financing the economic activity of non-financial corporations increased 22
Chart III.19. Economic growth of over 3.5% continued into 2004 Q3 24
Chart III.20. The GDP growth was linked chiefly with buoyant investment demand, stimulated by a surge in external demand 24
Chart III.21. Annual investment growth fluctuated around 10% for the second consecutive quarter 25
Chart III.22. The downward trend in real consumption expenditure growth continued 25
Chart III.23. The slower household consumption growth was due mainly to high inflation eroding the purchasing power of households' income 26
Chart III.24. The annual decline in government final consumption expenditure deepened at the end of 2004 26
Chart III.25. Export growth was markedly higher than import growth in 2004 Q3 26
Chart III.26. The adverse trend in negative net exports halted in 2004 Q3 27
Chart III.27. Trade, services and industry were the biggest contributors to GDP 27
Chart III.28. Exports continued to account for almost half of industrial firms' sales 27
Chart III.29. Fast-growing earnings generated a higher profit-equity ratio 28
Chart III.30. On the labour market, the gap between labour supply and demand narrowed further 29
Chart III.31. The upturn in labour demand was indicated by renewed year-on-year growth in the number of employees in 2004 Q3 29
Chart III.32. The rise in vacancies was not accompanied by a corresponding fall in the number of people unemployed 30

Chart III.33. A stronger rise in employment was prevented by structural unemployment, as indicated by the high long-term unemployment rate 30
Chart III.34. Annual growth in whole-economy labour productivity has slackened since the start of 2004 31
Chart III.35. The personnel cost-output ratio at the macro-level rose somewhat in 2004 Q3 31
Chart III.36. The relatively high industrial producer price inflation — linked with high growth in input prices — fell somewhat at the end of 2004 31
Chart III.37. The impacts of the fast-rising world prices of energy-producing materials on import prices were strongly corrected by the koruna-dollar exchange rate 32
Chart III.38. The rise in industrial producer price inflation in October was due mainly to a surge in prices in the mining industry 33
Chart III.39. But oil- and metal-processing industries contributed most to the annual rise in industrial producer prices 33
Chart III.40. The fast rise in industrial producer prices was not across the board in nature 33
Chart III.41. Underlying the modest overall rise in agricultural producer prices were contrary movements in crop and livestock product prices 34
Chart III.42. Market services price inflation rose slightly at the end of 2004 34
Chart IV.1. The output gap will close at the beginning of 2006 38
Chart IV.2. The centre of the inflation forecast is slightly below the point inflation target at the monetary policy horizon 39

BOXES AND ANNEXES CONTAINED IN PAST INFLATION REPORTS

Price indices used for the evaluation of inflation	(Box)	April 1998
Analysis of the money supply trend	(Box)	July 1999
Revisions to the statistical data on GDP	(Box)	July 1999
Measuring the inflation expectations of the financial market	(Annex)	October 1999
Oil prices and their impact on inflation	(Box)	July 2000
The effect of oil price changes on the balance of trade	(Box)	October 2000
The methodological framework for evaluating wage developments relative to inflation	(Box)	January 2001
The CNB's monetary policy rates	(Box)	April 2001
The setting of the inflation target for 2002—2005	(Annex)	April 2001
Harmonisation of the reserve requirements with European Central Bank standards	(Annex)	April 2001
Escape clauses pertaining to the new inflation target	(Annex)	July 2001
Changes in economic growth forecasts in the eurozone, Germany, the USA and Japan for 2001 and 2002	(Annex)	October 2001
Strategy for dealing with the exchange rate effects of capital inflows from privatisation of state property and from other foreign exchange revenues of the state	(Annex)	January 2002
Assessment of fulfilment of the CNB's net inflation target in December 2001	(Annex)	January 2002
Prediction of external variables	(Box)	April 2002
Estimated capital flows in 2002 and 2003 and their effect on the exchange rate	(Box)	April 2002
The Balassa—Samuelson effect	(Annex)	April 2002
The CNB changes its type of inflation forecast	(Box)	July 2002
An assessment of the effect of the August floods on Czech economic growth	(Box)	October 2002
The financial conditions of the Czech Republic's accession to the EU	(Box)	January 2003
Implications of the unexpectedly slow growth in regulated prices	(Box)	January 2003
The Czech Republic and the euro — Draft accession strategy	(Annex)	January 2003
Fiscal consolidation and its effect on economic growth	(Annex)	January 2003
Price deregulation in the period of transformation of the Czech economy	(Box)	April 2003
Revisions to the March 2003 GDP figures	(Box)	April 2003
Credit to households	(Box)	July 2003
The withdrawal of 10- and 20-heller coins and its possible impact on prices	(Box)	July 2003
Indirect taxes and the inflation forecast	(Box)	July 2003
Changes to the methodology for surveying inflation expectations	(Box)	July 2003
ERM II and the exchange-rate convergence criterion	(Annex)	July 2003
Use of the output gap indicator at the CNB	(Box)	October 2003
Monetary policy in the CNB's macroeconomic forecast	(Box)	October 2003
The Czech Republic's euro-area accession strategy	(Annex)	October 2003
Short-run food price prediction methods	(Box)	January 2004
Monetary conditions	(Box)	April 2004
The CNB's inflation target from January 2006	(Annex)	April 2004
The exchange rate in the CNB's forecasting system	(Box)	July 2004
The CNB has fully integrated into the European System of Central Banks	(Annex)	July 2004
Petrol prices and their impact on inflation in the Czech Republic	(Box)	October 2004
Indicators of households' financial situation	(Box)	October 2004
GDP data revision	(Box)	October 2004
The structure of lending	(Box)	January 2005
Uncertainty regarding the evolution of public finances in 2005 and 2006	(Box)	January 2005
Inflation expectations in the CNB's modelling system	(Box)	January 2005
Assessment of the fulfilment of the Maastricht convergence criteria and the degree of alignment of the Czech economy with the euro area	(Annex)	January 2005

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
EC	European Commission
ECB	European Central Bank
EEA	European Economic Area
EIB	European Investment Bank
EMU	Economic and Monetary Union
ERM	European Exchange Rate Mechanism
ESA	European System of Accounts
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)
FRA	forward rate agreement
GDP	gross domestic product
HICP	Harmonised Index of Consumer Prices
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.)
MF CR	Ministry of Finance of the Czech Republic
MIT	Ministry of Industry and Trade of the Czech Republic
NBS	National Bank of Slovakia
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

FOREWORD

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 differs from previous ones in appearance, structure and content. In addition to graphical changes throughout the document, changes have been made to the structure of section III, with the addition of two separate subsections describing the latest developments in the external environment and the balance of payments. Changes have also been made in section IV., where the number of charts and tables has been increased to give a clearer account of the message of the latest Czech National Bank forecast. These changes are aimed at making the Inflation Report better organised and richer in content.

The Annex to the January Inflation report is a document that analyses the current and expected fulfilment of the Maastricht convergence criteria and degree of economic alignment of the Czech Republic with the euro area. Based on this analysis, the document recommends that the Czech Government should not attempt to enter the ERM II during 2005. The document was prepared by the Ministry of Finance of the Czech Republic, the Ministry of Industry and Trade of the Czech Republic and the Czech National Bank, and was approved by the Government of the Czech Republic at its meeting on 12 January 2005.

This Inflation Report was approved by the CNB Bank Board on 3 February 2005. Unless stated otherwise, the sources of the data presented 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/.

I. SUMMARY

Annual consumer price inflation continued fluctuating near the centre of the target band in 2004 Q4 (see Chart I.1.). The rate of growth of the Czech economy slowed somewhat in 2004 Q3, but some labour market indicators developed favourably in Q3 and Q4. Interest rates at longer maturities declined slightly in Q4. The koruna's exchange rate appreciated against the dollar and, to a lesser extent, against the euro.

After picking up in October, annual consumer price inflation slowed in the remaining months of 2004 Q4, fluctuating just below the 3% level. The October increase in inflation was attributable primarily to pass-through of higher natural gas and fuel prices into other price categories. The lagged effect of tax changes acted in the same direction, affecting the prices of some services (most notably public telecommunications services, housing services, and hotel and restaurant services). The slowdown in inflation in November and December was due chiefly to food prices, which were affected — with a lag — by a marked decline in annual agricultural producer price inflation during the latter half of the year. The impact on domestic prices of the high prices of energy-producing materials and metals on world markets was dampened to a large extent by the koruna's stronger exchange rate against the dollar.

The Czech economy grew slightly more slowly in 2004 Q3 than in Q2, despite a downward revision to the Q2 figure. The growth continued to be driven primarily by investment, whereas final consumption fell slightly year on year. Underlying this was a deepening year-on-year decline in government consumption, which the weak growth in household consumption failed to offset. Besides investment, foreign trade contributed to the growth of the Czech economy for the first time in more than two years. The positive contribution of net exports to the growth resulted from an increasing lead of annual goods export growth over import growth.

The continuing stable economic growth and the creation of new FDI-related jobs further improved the labour market situation. The result was a continuing slowdown of the employment decline in Q3, along with a rise in vacancies and a stabilised unemployment rate in both Q3 and Q4. Wage growth picked up again in Q3 after the extraordinary factors that caused it to slow sharply in Q2 unwound.

On the money market in Q4 there was a gradual modest decline in interest rates at longer maturities, chiefly reflecting a deferral of the expected growth in monetary policy interest rates to a later date. The main trend on the foreign exchange market in Q4 was the appreciation of the koruna's exchange rate against the dollar and, to a lesser extent, against the euro. This appreciation reflected a number of short-term factors as well as the continuing weakening of the dollar against the euro. In the longer term, however, there are no fundamental reasons for a significantly stronger koruna-euro rate.

The monetary policy decision-making of the CNB Bank Board in 2004 Q4 was based on the inflation forecast discussed by the Board at its meeting on 27 October 2004 and published in the October Inflation Report. Given the monetary policy transmission lag, the Board focused on hitting the inflation target in October 2005—March 2006. According to the forecast, inflation should

CHART I.1.

Inflation continued fluctuating near the centre of the target band in 2004 Q4
(annual consumer price inflation; percentages)

TABLE I.1.

Inflation fell in the last two months of 2004 Q4
(annual percentage changes unless otherwise indicated)

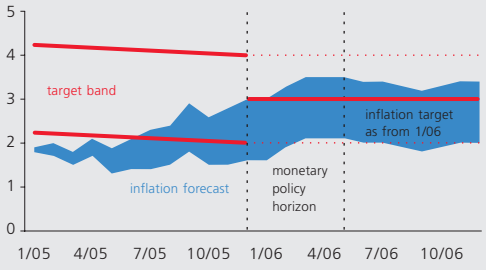
	9/04	10/04	11/04	12/04
Consumer price inflation	3.0	3.5	2.9	2.8
Industrial producer price inflation	8.0	8.6	8.2	7.7
Money supply growth (M2)	8.5	7.8	6.6	x
3M PRIBOR [a] (in per cent)	2.7	2.7	2.6	2.6
Nominal CZK/EUR exchange rate [a] (level)	31.60	31.48	31.29	30.65
State budget balance since January incl. SFAOs [b] (CZK bn)	-40.5	-59.5	-66.4	-93.5
GDP growth at constant prices [c]	3.6	—	—	x
Unemployment rate [b] (in per cent)	10.1	9.9	9.9	10.3

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

CHART I.2.

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

(annual consumer price inflation; percentages)



be close to the centre of the target band in this period. Consistent with the forecast was a moderate rise in interest rates in the longer run.

The Bank Board made no changes to monetary policy interest rates in 2004 Q4. The evolution of interest rates in this period was consistent with the forecast, and the associated risks did not suggest any need to change these rates. Given the evolution of cost factors, these risks were assessed by the Bank Board in the first two months of the quarter as moderately inflationary. In the third month, though, they were found to have moved slightly in an anti-inflationary direction, owing to greater-than-forecasted appreciation of the koruna's real exchange rate against the euro and the dollar, slower growth of the German economy and a lower outlook for foreign interest rates.

The Inflation Report concludes with the CNB's new forecast. The January forecast, like the previous ones, foresees a pick-up in economic growth, driven mainly by investment and export growth, and a gradual closing of the output gap. However, the slower unwinding of the anti-inflationary demand pressures observed in the past and a downward revision of the external recovery move the closure of the output gap back to the beginning of 2006. 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 centre of the forecast is slightly below the CNB's point inflation target. Consistent with the January forecast and its assumptions is a moderate fall in interest rates in 2005 H1. Gradual interest rate growth has been put back to 2006 H1.

Together with the baseline scenario, two versions of an alternative scenario of different fiscal policy effects in 2005 and 2006 were drawn up. These reflect the current uncertainty regarding the contribution of fiscal policy to economic growth. The first alternative scenario assumes that reserves will continue to be created in the years ahead, whereas the second alternative scenario examines the possibility of a gradual dissolution of the existing reserves. The former would result in the need for slightly easier monetary policy by comparison with the baseline scenario, whereas the latter would require tighter monetary policy.

The annex to this Inflation Report is the full version of the Assessment of the Fulfilment of the Maastricht Convergence Criteria and the Degree of Alignment of the Czech Economy with the Euro Area. This document, which the CNB was involved in preparing, was approved by the Government of the Czech Republic on 12 January 2005. The aim of the document is to inform the Government about the current and expected fulfilment of the Maastricht convergence criteria and degree of alignment of the Czech economy with the euro area economy. In accordance with The Czech Republic's Euro-area Accession Strategy (see the October 2003 Inflation Report), the Minister of Finance — assisted by the Governor of the CNB — is required to submit such a document to the Government every year. The document recommends that the Czech Government should not attempt to enter the ERM II during 2005.

II. INFLATION DEVELOPMENTS

II.1. PAST INFLATION DEVELOPMENTS

The gradual increase in annual inflation observed since the beginning of 2003 peaked during 2004 Q3. Inflation rose in August to its highest level in 2004 (3.4%), but the opposite trend was recorded in the following months of the year. Annual inflation gradually declined from September onwards (except in October) to stand at 2.8% in December. The inflation rate[1] increased by 0.6 percentage point to 2.8% in December by comparison with the end of Q3.

The slowdown in annual consumer price inflation during 2004 Q4 was attributable chiefly to factors affecting food prices. The change in the food price trend compared to previous quarters was due in particular to a marked decline in annual agricultural producer price inflation. Counteracting this was higher growth in regulated prices, caused by an increase in the average price of natural gas for households (of around 11%). This was also the main cause of the stronger rise in consumer price inflation in October and the consequent slower decline in its annual outturns from the end of 2004 Q3. The first of the aforementioned factors fostered a sharp fall in annual food price inflation, whereas the second caused inflation to rise in the category of housing, water, electricity, gas and other fuels (see Table II.1.).

Consumer prices in 2004 Q4 again showed no signs of more pronounced inflationary effects stemming from the surge in prices of imported inputs ongoing for more than a year. Growth in prices of some key commodities (oil, gas and metals) on world markets steadily rose to exceptionally high levels, but their impact on domestic prices was dampened to a large extent by appreciation of the koruna (most notably against the dollar). Import prices of the aforementioned raw materials and the semi-manufactures made from them still rose quite quickly during 2004. Nevertheless, the gradually strengthening growth in industrial producer prices was still not across the board in nature. Only in industrial branches engaged directly in processing imported raw materials and semi-manufactures did producer prices rise quickly, and a major secondary effect was visible in only one industry as yet (the chemical industry). Producer prices in most other manufacturing branches either grew modestly or declined year on year.

There are several reasons for the lack of stronger or wider pass-through of the rising prices of imported inputs into producer prices and on into consumer prices[2]. Above all, the terms of trade remained favourable and the personnel cost-output ratio in industry continued to fall year on year. The length and intensity of the transmission of external cost pressures into prices is also dependent on the share of imported raw materials and semi-manufactures in the total inputs of a particular product and product type. In the case of more sophisticated products with higher value added, a longer transmission time can be expected, as is demonstrated by the current evolution of producer prices.

CHART II.1.

Annual inflation declined in 2004 Q4

(percentages)

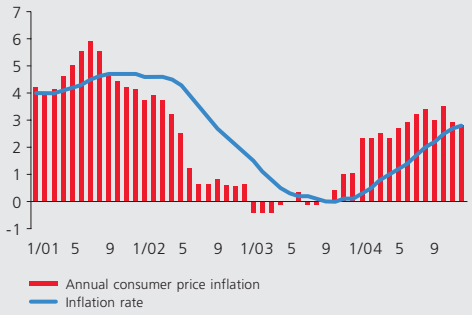


TABLE II.1.

Food prices contributed most to the decline in annual inflation in 2004 Q4

(annual percentage changes)

	6/04	7/04	8/04	9/04	10/04	11/04	12/04
Consumer prices	2.9	3.2	3.4	3.0	3.5	2.9	2.8
Food and non-alcoholic beverages	2.8	4.5	5.1	3.6	2.4	0.4	0.9
Alcoholic beverages and tobacco	3.9	4.2	4.4	4.1	4.2	3.8	3.5
Clothing and footwear	-4.1	-4.3	-4.0	-3.9	-3.1	-3.1	-3.1
Housing, water, electricity, gas and other fuels	2.5	2.6	2.6	2.8	4.4	4.4	4.4
Furnishings, household equipment and routine maintenance of the house	-1.8	-1.9	-1.8	-1.8	-1.9	-1.9	-2.0
Health	3.7	3.0	3.1	3.6	3.5	3.7	3.6
Transport	3.7	3.7	3.3	2.0	2.9	2.8	1.4
Communication	13.0	12.9	11.5	11.5	13.0	12.9	12.9
Recreation and culture	2.0	2.1	2.4	2.6	2.0	1.7	1.7
Education	1.1	1.1	1.1	6.2	5.4	5.4	5.4
Hotels and restaurants	7.2	7.1	7.1	7.7	8.0	7.9	7.9
Miscellaneous goods and services	5.0	5.2	4.9	4.6	4.1	4.3	4.4

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

2 A stronger impact was recorded in the case of consumer prices of fuels and prices of gas for households.

CHART II.2.

Owing to higher regulated price inflation and lower market price inflation, the share of regulated prices in annual consumer price inflation was higher in 2004 Q4

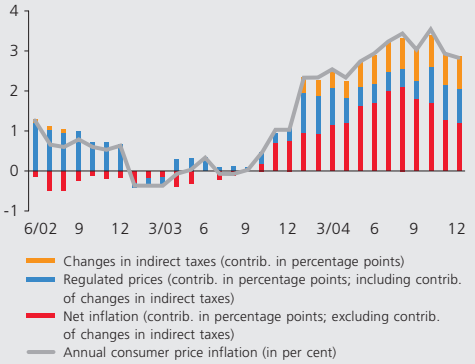


CHART II.3.

A change in the agricultural producer price trend fostered slower growth of food prices

(annual percentage changes)

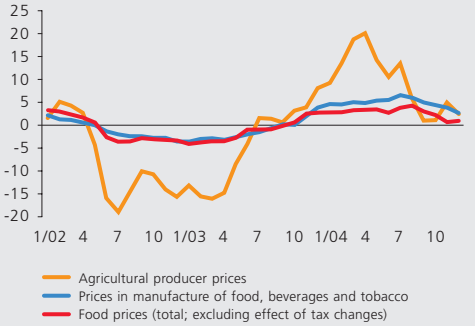
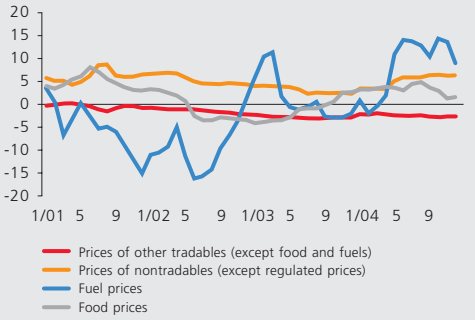


CHART II.4.

Fuels remained the market commodity with the fastest-rising prices

(annual percentage changes, including indirect tax changes)



Developments on the demand side did not create conditions for faster growth in inflation, either. Economic growth remained fairly stable, staying above 3.5%, although the economy remained below potential output and real consumer demand growth decreased steadily. Last but not least, an across-the-board rise in inflation was also counteracted by persisting strong domestic and foreign competition, reflected primarily in prices of consumer products and mostly falling prices of imports for final consumption. Retail chains' continuing efforts to win a larger market share also bolstered the strongly competitive environment on the market.

In these circumstances, there was no major change in the structure of the price movements of the items in the consumer basket at the end of 2004 compared to the previous quarter, except for the aforementioned food prices and prices of housing, water, electricity, gas and other fuels (see Table II.1.). This fact is also indicated by the market price structure (see Chart II.4.).

Overall, growth in market prices, as measured by net inflation[3], eased in 2004 Q4 (to 1.5% in December), mainly because of food prices. By contrast with previous quarters, when food price inflation had surged and had been the main factor underlying the rise in consumer prices, food prices showed a pronounced decrease in growth at the end of Q3 and in Q4 (from 4.2% in August to 0.9% in December year on year, excluding the effect of indirect taxes). The primary cause of this change was a sizeable year-on-year decline in agricultural producer prices in crop production[4] in 2004 H2 (fruit, vegetables, cereals, potatoes), which passed through into consumer prices with a short lag and was only partly offset by growth in prices in some other categories[5]. The decrease in food price inflation was also due to base effects, as a large increase in cereals prices the previous year had led to faster growth of bread prices[6].

Price movements within the non-food market commodities category remained very mixed. Fuel prices continued to show the fastest growth (8.9% in December including the effect of tax changes). However, their year-on-year growth was much lower than the growth rates recorded by oil prices on world markets. Besides demand-side factors, growing competition between fuel sellers and a long-running decline in margins in fuel production, distribution and sale[7], the year-on-year appreciation of the koruna-dollar exchange rate contributed in large measure to this difference in price growth rates[8]. The relatively high year-on-year growth in fuel prices was also fostered by changes to excise duties, which had an impact of around 3 percentage points. By contrast, other tradable non-food commodities[9] recorded a continuing year-on-year decline in prices, which in 2004 Q4 merely eased slightly (to 2.6% in December). This trend was in line with the mostly falling prices of imported consumer goods and prices of domestic consumer goods manufacturers. As with other imports, import prices of consumer products were strongly affected by the appreciation of the koruna's exchange rate, which cushioned the impacts of foreign inflation on domestic prices.

3 Net inflation = growth in the consumer price index net of regulated prices and adjusted for other administrative measures.
4 See section III.7. *Import prices and producer prices* — Chart III.41.
5 Annual growth of sugar prices reached 40.8% in October and 34.8% in November.
6 Annual growth of bread prices slowed from 13.3% in October to 2.3% in November.
7 For details see the box *Petrol prices and their impact on inflation in the Czech Republic* in the October 2004 Inflation Report.
8 In December, the koruna-dollar exchange rate appreciated by 13.1% year on year.
9 Excluding fuels.

Growth in prices of market nontradable commodities — affected predominantly by factors of domestic origin — did not rise further in the last two months of 2004 Q4, fluctuating broadly at their end-2004 Q3 levels (6.3% year on year). The main contributors to this year-on-year growth were rapidly rising prices in education, health and communication services, which were strongly affected by their May transfer to the higher VAT rate.

Turning to international comparisons, annual consumer price inflation in the Czech Republic remained just above the level in the EU countries at the end of 2004. However, this difference narrowed thanks to the fall in consumer price inflation in the Czech Republic. The faster rise in inflation in the Czech Republic during 2004 compared to the EU average was largely due to domestic factors — growth in regulated prices and indirect taxes. In November, the annual HICP was 2.6% in the Czech Republic and 2.2% in the EU countries. According to the latest figures for December, the HICP in the Czech Republic was down slightly at 2.5% and the flash estimate of the HICP in the EU was 2.3%.

II.2. FULFILMENT OF THE INFLATION TARGET

Actual inflation was within the CNB's target band in 2004 Q4 (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 roughly 12 to 18 months. Accordingly, to assess the effect of monetary policy on the fulfilment of the inflation target in 2004 Q4, one needs to analyse retrospectively the forecasts — and the Bank Board's decisions based thereon — dating from around April 2003 to December 2003. For simplicity, the analysis of the accuracy of the CNB's forecasts is limited here to a comparison of the forecast drawn up in July 2003, i.e. approximately in the middle of the aforementioned period, with inflation in 2004 Q4 (see Table II.2.).

The July 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. However, the effect of the easy monetary policy on the closure of the output gap was expected to be dampened by a delay in the onset of external economic growth, so the forecast was for only slow closure of the output gap. The forecasted return of inflation from its low outturns in July 2003 to the target in the course of 2004 was thus primarily due to expected changes to indirect taxes linked with the fiscal reform and with harmonisation with EU rules (see the July 2003 Inflation Report). The consumer price inflation outturn in 2004 Q4 was almost in line with the forecast (0.1 percentage point lower). A more detailed look at the inflation structure reveals that by comparison with the forecast the contributions of food prices, adjusted inflation excluding fuels and the changes to indirect taxes were lower. By contrast, fuel prices and regulated prices grew faster than forecasted in July.

The fulfilment of the July forecast for overall consumer price inflation can thus be put down to fulfilment of the forecasts for administrative effects and for external demand (see Table II.3.) and to a combination of higher oil prices, a more depreciated dollar-euro exchange rate and tighter monetary policy. The partial errors associated with imperfections in the CNB's forecasting system this time roughly offset each other.

CHART II.5.

The impact of rising oil prices on consumer prices of fuels was dampened by several factors

(annual percentage changes)

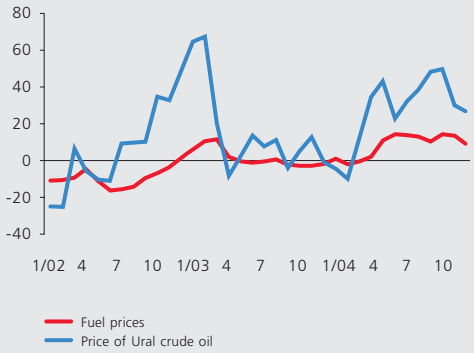


CHART II.6.

Consumer price inflation in the Czech Republic remained higher than in the EU Member States in 2004 Q4

(annual percentage changes)

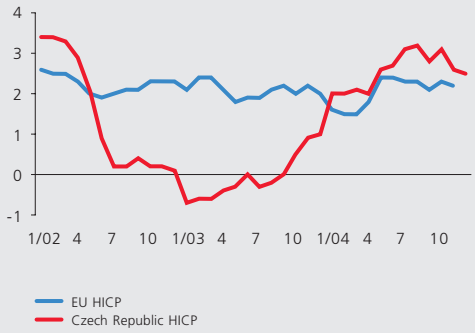


TABLE II.2.

Headline inflation at the end of 2004 was almost in line with the July 2003 forecast

(annual percentage changes; contributions in percentage points)

	July 2003 forecast	2004 Q4 outturn	Contribution to total difference. in p. p.[a)]
Annual consumer price inflation	3.1	3.0	-0.1
Breakdown into contributions:			
regulated prices	3.0	3.4	0.1
indirect taxes	1.0	0.9	-0.1
food prices, excluding effects of indirect taxes	2.2	1.3	-0.2
fuel prices, excluding effects of indirect taxes	-0.9	9.0	0.3
adjusted inflation excluding fuels, excluding effects of indirect taxes	2.0	1.7	-0.2

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

TABLE II.3.

External demand developed broadly in line with the July 2003 forecast's assumptions

		III/03	IV/03	I/04	II/04	III/04	IV/04
GDP in Germany	prediction	0.1	0.4	1.0	1.4	1.7	1.9
(annual perc. changes)	outturn	-0.3	0.2	1.5	1.9	1.3	x
CPI in Germany	prediction	0.7	0.9	0.5	0.9	1.2	1.4
(annual perc. changes)	outturn	1.0	1.2	1.1	1.8	1.9	2.0
1Y EURIBOR	prediction	2.1	2.1	2.1	2.3	2.5	2.6
(percentages)	outturn	2.2	2.4	2.1	2.3	2.3	2.3
USD/EUR exchange	prediction	1.18	1.18	1.18	1.18	1.17	1.16
rate (levels)	outturn	1.12	1.19	1.25	1.20	1.22	1.28
Oil prices	prediction	23.9	22.7	22.4	22.3	22.3	22.3
(USD/barrel)	outturn	27.2	27.5	29.8	32.2	38,0	37.1

Consistent with the July forecast was a fall in interest rates in 2003 H2 and interest rate stability during 2004. In reality, however, interest rates only declined in 2003 Q3. Thereafter they flattened out and in 2004 Q2 they started rising. In the key period as regards the most recent consumer price developments (2003 Q2—Q4), interest rates were broadly in line with the forecast in both nominal and real terms. Despite a more depreciated nominal exchange rate of the koruna against the euro, the exchange rate effect was tighter than forecasted in July, because of a lowering of the estimated rate of equilibrium appreciation. Overall, the monetary conditions were slightly tighter by comparison with the July forecast, but they remained easy in their effect on the economy.

The current assessment of the fulfilment of the July forecast is also affected by changes in the CNB's view on the functioning of the economy since the July forecast was prepared. Since July 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 July 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 July forecast, they would — given their opposite natures — have acted neutrally on the output gap, albeit towards higher inflation in 2004 Q4. Given the lower rate of equilibrium appreciation, the forecast would have implied a more depreciated 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 of actual economic developments, the developments since the July forecast was drawn up can be briefly interpreted in the following way.

TABLE II.4.

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

		III/03	IV/03	I/04	II/04	III/04	IV/04
3M PRIBOR	prediction	2.1	1.9	1.7	1.8	1.9	2.2
(percentages)	outturn	2.1	2.1	2.1	2.2	2.6	2.6
CZK/EUR exchange	prediction	31.5	31.5	31.5	31.6	31.7	31.7
rate (levels)	outturn	32.16	32.1	32.9	32.0	31.6	31.3
GDP (real, annual	prediction	2.6	3.1	2.6	3.0	3.0	3.1
perc. changes)	outturn	4.0	4.0	3.5	3.9	3.6	x
Output gap	prediction	-2.4	-2.2	-2,3	-2,2	-1.8	-1.3
(percentages of GDP)	outturn*	-1.6	-1.6	-1.3	-1.0	-0.9	-0.8

*estimate based on the CNB's January 2005 forecast

Despite rather tighter monetary conditions in the key period (April 2003—December 2003) and fulfilment of the assumptions regarding external demand, the output gap in 2003 and 2004 was revised in the direction of 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 imperfections either in the CNB's forecasting system or in the CZSO's economic growth measurements. The slightly lower growth in adjusted inflation excluding fuels and lower growth in food prices relative to the forecast were partly offset by higher fuel price growth.

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 Q2 (see the relevant minutes) the risks were perceived as markedly anti-inflationary. In 2003 Q3 they were seen as symmetrical and in 2003 Q4 as slightly inflationary. The Bank Board's overall symmetrical perception of the risks, which led to interest rates being set broadly in line with the assumptions of the July forecast, contributed to the fulfilment of the inflation target in 2004 Q4.

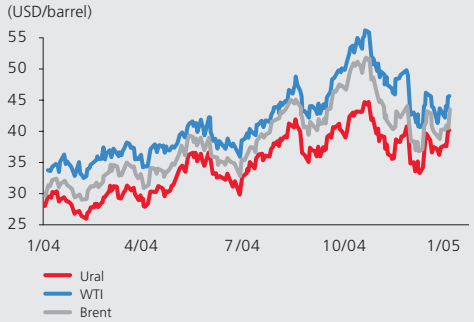
III. INFLATION FACTORS

III.1. THE EXTERNAL ENVIRONMENT

The global economic recovery continued into 2004 Q3, creating favourable macroeconomic conditions for growth in the Czech Republic as well. However, in the most important regions — the USA and the euro area — this recovery slowed somewhat. Oil prices were one of the risk factors throughout last year. Owing to the global recovery, and in particular the demand for energy in the rapidly growing China, oil prices climbed steadily, peaking in October at an average monthly WTI crude oil price of USD 53 per barrel. Since then this price has been gradually falling, its monthly level being USD 10 lower in December. Other key raw materials — natural gas, steel, non-ferrous metals — followed a similar trend. Another important factor for world stability was the uncertainty regarding the dollar's exchange rate, associated with the USA's current account deficit of around 5% of GDP. The dollar weakened against the euro throughout Q4, reaching a record level of over USD 1.36/EUR at the end of the year.

CHART III.1.

Oil prices were a source of uncertainty throughout the period



Annual GDP growth in the USA declined, from 4% in Q3 to 3.1% in 2004 Q4. Growth remained strong in manufacturing and services. The recovery was still being driven mainly by household consumption and investment. The situation on the labour market also improved. The unemployment rate was only 5.4% in December, and a total of 2.2 million jobs were created last year. The Fed raised its key interest rate by 25 basis points at every FOMC meeting over the past period. The rate thus increased from the initial 1% to 2.25% in December. This means that the Fed has so far stuck to its declared intention to move its rate gradually towards the neutral level.

Inflation in the USA gradually increased, owing to oil and commodity prices, the weakening dollar and the improving labour market situation. Consumer prices were up by 3.2% in October and 3.6% in November in year-on-year terms. The largest increases were recorded for food, automobile and health care prices. The trend in producer prices and subsequently in consumer prices changed only after commodity prices showed a reversal in trend and annual consumer price inflation slowed to 3.4% in December.

GDP growth also declined in the euro area, from 2.1% in Q2 to 1.8% in Q3. This was due to weaker export performance, higher imports and low household consumption. Industrial production and the labour market were both stagnant, and the unemployment rate remained at 8.9%. Consumer and producer price inflation, which had been gradually increasing throughout the year, saw a change in trend owing to the reversal in commodity price growth. Annual consumer price inflation fell from 2.4% in October to 2.2% in November and annual producer price inflation from 4% to 3.6% in the same period. Besides raw materials prices, this reversal was attributable to the strengthening euro and falling GDP growth. In December, consumer price inflation picked up again, to 2.4% according to preliminary data. The largest increases were recorded for energy, tobacco and health care prices. The ECB left its rates unchanged at 2% during 2004 Q4. The yield curve flattened during this period. The less favourable outlook for GDP growth was reflected in a decline in long-term rates, whereas short-term rates (3M EURIBOR) increased.

CHART III.2.

The dollar started to plunge in value in May 2004

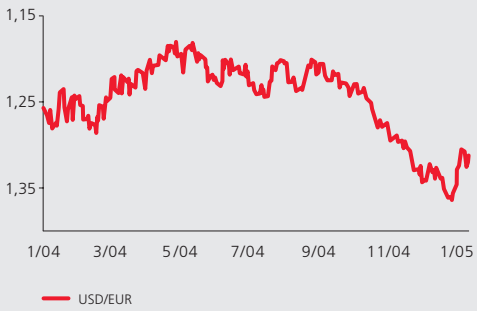
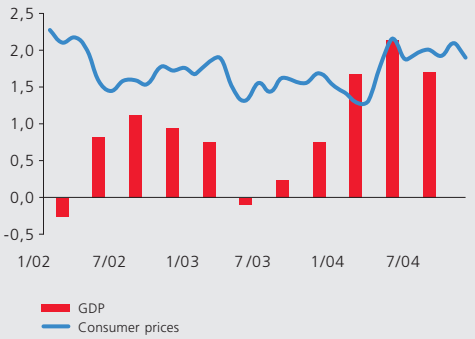


CHART III.3.

Economic growth in the "old" EU Member States slowed in 2004 Q3

(annual percentage changes)



The low annual growth of the German economy in Q2 (1.4%), based on sizeable export growth, decreased by 0.1 percentage point in the following quarter owing to the strong euro. This affected industrial production, which until then had been the main driver of the recovery, and the unemployment rate subsequently increased to 9.9% (one of the highest figures in the euro area). Consumer price inflation in Germany rose from 2% in November to 2.2% in December.

Developments in the "old" EU countries outside the euro area were much more favourable than in the euro area. Economic activity in the United Kingdom and Sweden grew by 3.1% and 3.7% respectively in Q3. These countries also enjoy lower unemployment (between 4.5% and 6.5%). In addition to GDP growth close to potential output growth, the United Kingdom recorded one of the lowest unemployment rates in the EU (4.5%) and very modest inflation of 1.6%. In this situation, the central bank left its interest rates unchanged at 4.75%.

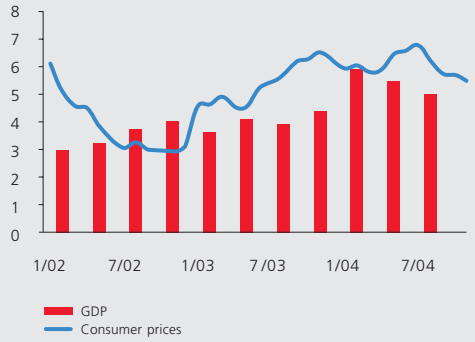
The most important "new" EU Member States for the Czech Republic are those in the Central European region — Slovakia, Poland and Hungary. The whole region is characterised by higher inflation and GDP growth compared to the euro area, strong inflows of foreign investment, substantial current account deficits, a slight slowdown in economic activity in Q3 and currency appreciation.

The highest GDP growth was registered in Slovakia. Its remarkable growth figure of 5.4% in Q3 was achieved thanks to a strong inflow of foreign investment, which had a positive effect on fixed capital formation (12%). Rapid economic growth last year helped reduce its unemployment rate to 13.5%. Inflation was high, but slowed significantly from 8.5% in July 2004 to 5.8% in December. The National Bank of Slovakia maintained its monetary policy rate (4%) below the inflation level, because, according to its leading representatives, it was trying to prevent or slow the appreciation of the Slovak koruna, which it considered dangerous from the point of view of future economic developments.

CHART III.4.

GDP rose much faster in the "new" EU Member States than in the euro area

(annual percentage changes)



Annual economic growth in Poland fell from 6.1% in Q2 to 4.8% in Q3. This still high figure was due to investment and personal consumption growth. The continuing relatively brisk growth helped the unemployment rate fall to 18.7% last year. Thanks to low nominal wage growth and appreciation of the zloty, inflation had remained unchanged at around 4.5% for six months. At 4%, the key interest rate was also unchanged.

The growth of the Hungarian economy, accompanied by some macroeconomic imbalances, moderated to 3.7% in Q3 from the previous 4.2%. Investment and household consumption were particularly favourable. The external imbalance increased, unemployment rose slightly (to 6.3%) and inflation, which slowed to 5.5% in December, remained relatively high. The decline in inflation enabled the central bank to lower its key monetary policy rate by 50 basis points to 9%.

III.2. INTEREST RATES AND THE EXCHANGE RATE

Both components of the real monetary conditions in 2004 Q4 can be characterised as easy. Whereas the easing of the interest rate component of the monetary conditions remained relatively stable, the exchange rate component gradually tightened owing to appreciation of the nominal exchange rate. The exchange rate appreciation poses a risk to economic growth. However, the present course of economic activity and inflation should be derived from the past evolution of the monetary

conditions, as expressed by their combined effect, which was also assessed as easy. The current setting of the monetary conditions subsequently affects the message of the forecast (see section IV.). The evolution of the interest rate and exchange rate components of the monetary conditions in Q4 is described below in more detail.

III.2.1. The interest rate component of the monetary conditions

In 2004 Q4, interest rates fell gradually at almost all maturities. The main reason for the revision of the previous rate increases was the repeated statements made by CNB Bank Board members regarding the setting of interest rates and the stability thereof in the near future. This was confirmed by the minutes of the Board's meetings, which stated that the decisions to leave rates at their current level in that period had been adopted unanimously. The 2W repo rate remained unchanged at 2.5%, the Lombard rate at 3.5% and the discount rate at 1.5%.

While the reductions on the money market did not exceed 0.4 percentage point, a more marked decline was recorded for medium-term and long-term rates (of up to 0.8 percentage point). This decline was due to movements in foreign rates (particularly in the euro area) and also to the publishing of the government bond issuance calendar for 2005 Q1. The Ministry of Finance announced its intention to issue a very limited volume of bonds. The market therefore started speculating that another eurobond issue was under preparation, which significantly increased interest in koruna-denominated government bonds. The rate levels also reflected other factors, for example the publication of macroeconomic indicators. The GDP growth figure was below the market's expectations. The fact that the GDP growth structure fostered an absence of demand-pull inflationary pressures in the Czech economy was important. PRIBOR spot quotations and FRA forward quotations at the end of 2004 indicated stable interest rates over the coming several months.

The PRIBOR yield curve gradually shifted to a lower level, except at its shortest end. As a result, its positive slope decreased. The spread between the 1Y PRIBOR and the 2W PRIBOR was 0.34 percentage point in December. The IRS yield curve also moved to a lower level, but the shift was more sizeable. In December, the average 5Y—1Y spread was 0.80 percentage point and the 10Y—1Y spread 1.35 percentage points.

The interest rate differential (PRIBID/CZK—LIBOR/EUR, USD) was affected by interest rate developments both abroad and on the domestic interbank market. Key rates in the two most important economies developed differently. The Fed continued raising rates (O/N rate: 2.25%), whereas the ECB, in a situation of an appreciating euro-dollar exchange rate, kept interest rates unchanged (repo rate: 2.0%). The interest rate differential decreased, with the differential vis-à-vis dollar rates even turning negative at some maturities.

Six auctions were held on the primary government bond market, with original maturities ranging from 3Y to 15Y and a total volume of CZK 20.2 billion. Demand strongly exceeded supply in all auctions, so in some of them the Ministry of Finance took advantage of the favourable prices and increased the original supply.

The mortgage bond market saw securities issues amounting to CZK 2.8 billion. Issuing activity also continued on the primary koruna eurobond market, where the outstanding volume at the end of 2004 was CZK 161.2 billion.

CHART III.5.
The CNB left key interest rates unchanged
(percentages)

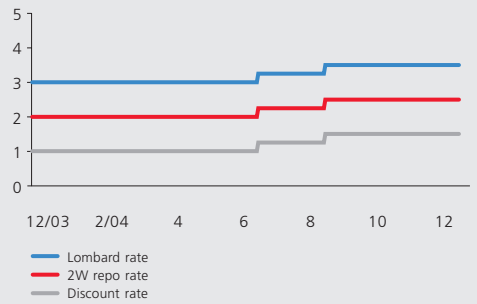


CHART III.6.
Market interest rates declined
(percentages)

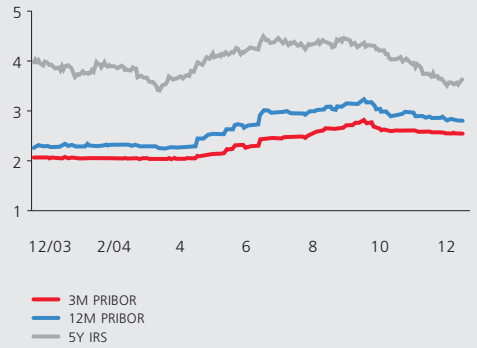


CHART III.7.
The interest rate differentials decreased
(percentage points)

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

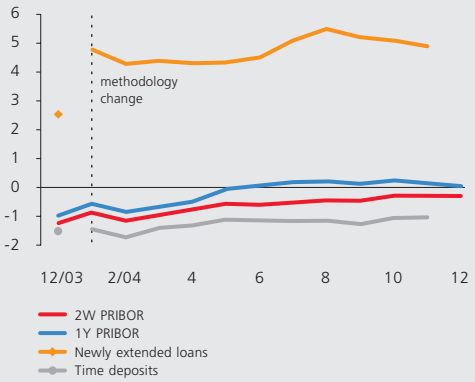


CHART III.9.
The koruna appreciated against both the euro and the dollar in 2004 Q4

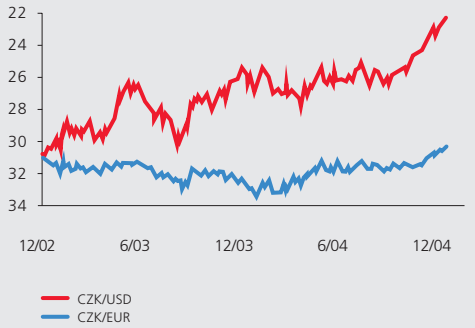
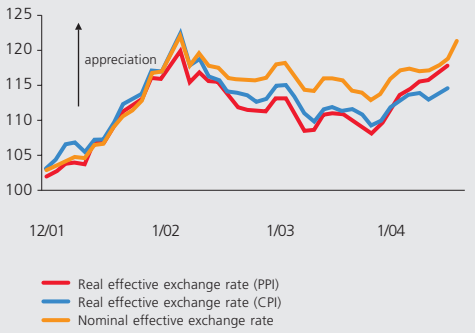


CHART III.10.
The nominal effective exchange rate appreciated year on year in 2004 Q4
(Year 2000 = 100)



The fall in interest rates on the financial markets had yet to feed through into client interest rates[10]. Nominal rates on new loans edged up to 6.1% in November. Rates on new time deposits were flat at 1.7%.

Real interest rates[11] were affected not only by the level of nominal rates, but also by movements in price indices. 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 4.9% in November, while real rates on time deposits were -1.0%.

III.2.2. The exchange rate

The average exchange rate of the koruna against the euro in 2004 Q4 was CZK 31.13/EUR, which represents a year-on-year appreciation of 3%. The appreciation trend visible since 2004 Q2 accelerated slightly in Q4. The main causes of this were a one-off rise in the supply of foreign currency on the market, associated with several major transactions, expectations regarding the privatisation of state property in 2005 (particularly the companies Telecom, Unipetrol and Vítkovice) and persisting positive sentiment about the Central European region on international financial markets. In addition, the exchange rate expectations were positively affected by a sizeable year-on-year fall in the trade deficit. The sole significant piece of bad news — a year-on-year widening of the current account deficit in 2004 Q1—Q3 due to a rise in non-residents' direct investment earnings — generated no market reaction. At the end of the quarter the appreciation trend picked up even further.

The average exchange rate of the koruna against the dollar in 2004 Q4 was CZK 24.06/USD, a year-on-year appreciation of almost 11%. This year-on-year strengthening was due primarily to the dollar's depreciation on world markets at the end of 2003 and in 2004 Q4 and, to a lesser extent, to the koruna's appreciation during 2004 Q2 and Q4. The appreciation of the koruna-dollar exchange rate gained pace in Q4, especially in December.

The nominal effective exchange rate of the koruna appreciated by about 3% year on year in Q4, owing mainly to the koruna's appreciation against the dollar and the euro. This appreciation was moderated above all by the koruna's exchange rate against the zloty and the Slovak koruna. The very modest year-on-year depreciation (of 0.7%) of the real effective exchange rate deflated by the CPI continued in January—October. This tendency primarily reflected lower inflation in the Czech Republic than abroad. By contrast, the real effective exchange rate deflated by the PPI appreciated slightly (by 1.3%), chiefly as a result of high annual growth in domestic producer prices.

III.3. The balance of payments

The current account deficit widened during the first three quarters of 2004. Underlying this trend were contrary movements in its component balances. The

10 Client interest rates underwent a change in methodology at the beginning of 2004. Newly drawn credits were replaced by newly extended loans, the reference date for which is the date of conclusion of the loan agreement. This better reflects the demand for loans at any given interest rate. This approach is in line with ECB methodology.

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

trade deficit decreased thanks to the better export performance of the Czech economy, but this positive effect was outweighed by the negative effect of continuing outflow of earnings in the form of dividends paid to non-residents. In 2004, the current account deficit was financed chiefly by capital inflow in the form of foreign direct investment and portfolio investment by non-residents. The CNB's international reserves recorded no major changes during 2004

III.3.1. The current account

In 2004 Q1—Q3 the current account deficit amounted to CZK 105.3 billion (5.1% of GDP), a year-on-year widening of CZK 12.4 billion (0.2 percentage point). Underlying this trend were contrary movements in its component balances. The widening of the total deficit was due mainly to a higher income deficit, as well as to a modest decline in the surplus on current transfers. By contrast, a decrease in the trade deficit and partly also a modest rise in the surplus on services counteracted this process. The current account thus primarily reflected the medium-term growth tendency of outflow of earnings in the form of dividends paid to non-residents. However, this tendency was increasingly moderated by continuing changes on the supply side with a positive effect on export performance.

The trade deficit amounted to just CZK 14.1 billion in the period under review, down by CZK 21.8 billion from a year earlier. In Q3, the deficit was CZK 5 billion and showed the best year-on-year improvement of 2004 (CZK 13.4 billion). Starting from Q2, the decline in the deficit was accompanied by a substantial pick-up in foreign trade growth, particularly exports of goods. The trade balance was greatly affected by favourable price developments (the annual terms of trade improvement for the three quarters was 2%), 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 immediate overall impact on the trade balance can be regarded as small. 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 36.3 billion). From the geographical perspective, the trade balance improvement was due to a wider trade surplus with the EU (25), which grew by CZK 44.3 billion.

The surplus on services saw only slight year-on-year growth (of CZK 1.7 billion) to CZK 12.1 billion. In Q3, this surplus was CZK 4.1 billion. The modest annual rise in the surplus was caused by a higher surplus on transport and travel. However, this was moderated by a wider deficit on other services (particularly financial and some commercial services).

The income deficit increased by CZK 30.7 billion year on year, to CZK 108.9 billion. In Q3, the income deficit was CZK 54.1 billion. The widening of the total deficit was largely due to an increased deficit in income from direct investment, resulting from a rising outflow of dividends. A rise in compensation of foreign employees and a fall in compensation of domestic employees abroad were also minor factors behind the deficit growth.

Current transfers ended in a surplus of CZK 5.6 billion, down by CZK 5.2 billion from a year earlier. In Q3, the current transfers surplus was a mere CZK 1.2 billion.

TABLE III.1.

The current account deficit increased, owing to growth in non-residents' profits

(CZK billions)

	I–III/01	I–III/02	I–III/03	I–III/04
A. Current account	-94.9	-92.1	-92.9	-105.3
Trade balance	-79.6	-40.8	-35.9	-14.1
Services	42.7	20.7	10.4	12.1
Income	-69.3	-83.2	-78.1	-108.9
Transfers	11.3	11.2	10.7	5.6
B. Capital account	-0.1	-0.1	-0.1	3.9
C. Financial account	98.9	316.1	95.1	103.1
Direct investment	147.0	247.5	89.2	89.9
Portfolio investment	19.0	6.7	-57.4	62.7
Financial derivatives	-0.9	-3.6	2.3	2.8
Other investment	-66.2	65.5	61.0	-52.3
D. Errors and omissions	20.0	-12.2	8.2	4.6
Change in reserves	-23.9	-211.7	-10.3	-6.3

(- = increase in reserves)

CHART III.11.

The trade deficit decreased significantly in 2004 Q3

(CZK billions)

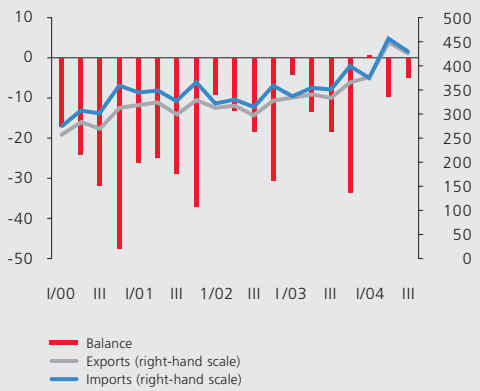


CHART III.12.

The income deficit increased significantly in 2004 Q3

(CZK billions)

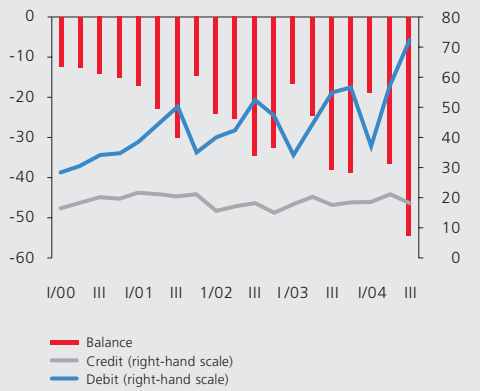


CHART III.13.
Slovakia became the largest foreign investor

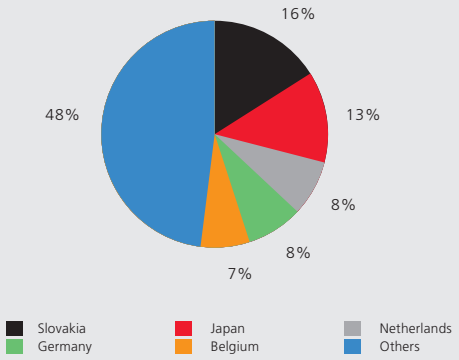
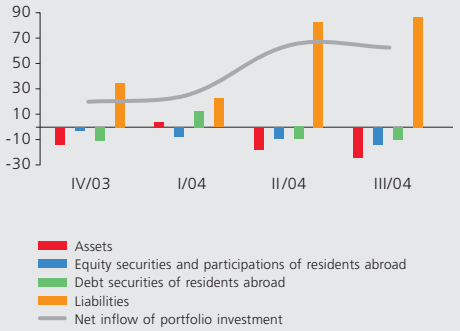


CHART III.14.
The net inflow of portfolio investment decreased somewhat in Q3
(CZK billions)



The year-on-year decrease in the surplus was affected by the termination of flood-related reinsurance payments and also by new expenditure associated with EU membership (with simultaneous recording of some revenues from EU funds under the capital account).

III.3.2. The financial account

The financial account recorded a surplus of CZK 103.1 billion (5.0% of GDP) in 2004 Q1—Q3, a rise of almost one-tenth compared to the same period of 2003. The net inflow of capital was due mostly to foreign direct and portfolio investment and, to a lesser extent, to renewed borrowing by the business sector. The net capital inflow was moderated by outflow of capital through the banking sector. The FDI inflow showed no major year-on-year changes, whereas the changes in other areas were quite significant. In the end, however, they offset each other, as the need for capital to finance the current account deficit was also little changed year on year.

The net inflow of direct investment was CZK 89.8 billion in the period under review, just as in the same period of 2003. The inflow of foreign direct investment (including reinvested earnings) was CZK 92.1 billion, which represents a year-on-year rise of around CZK 3 billion, roughly corresponding to the year-on-year rise in reinvested earnings. At CZK 34.8 billion, the direct investment inflow was somewhat higher in Q3 than in previous quarters (however, almost the entire increase was due to the sale of a minority share in electricity distribution company Pražská energetika for CZK 4.1 billion). The capital inflow from abroad (CZK 42 billion) 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 outflow of direct investment abroad remained negligible at CZK 2.3 billion, despite rising year on year.

The net inflow of portfolio investment was CZK 62.7 billion, contrasting with the outflow of CZK 57.4 billion recorded in the same period of 2003. The large year-on-year change — of around CZK 120 billion — was due mainly to a fall in residents' interest in investing in foreign debt securities (CZK 70 billion), probably thanks to a rise in the attractiveness of domestic investments (due, in turn, to the koruna's interest rate differential against the euro, expectations of appreciation of the koruna and rising prices of domestic shares) and to the first government bond issue on foreign markets (CZK 42 billion). Portfolio investment by residents on foreign markets reached CZK 24.0 billion, representing an annual reduction in outflow to about one-third. Interest in shares slightly prevailed. The inflow of portfolio investment from abroad reached a record CZK 86.6 billion, more than six times the inflow in the same period of 2003. Interest in bonds 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. To a lesser extent, this increase was fostered by non-residents' rising interest in government koruna bonds and domestic shares. Non-residents' holdings of domestic shares increased by CZK 20.3 billion in 2004 Q1—Q3 (compared to just CZK 3.4 billion in the same period a year earlier). In Q3, however, there was a very slight capital outflow (CZK 1.4 billion), due mostly to a temporary decrease in non-residents' interest in domestic shares.

Financial derivatives transactions generated a CZK 2.8 billion rise in the financial account surplus.

In the area of other investment there was a net outflow of CZK 52.2 billion, generated exclusively by bank transactions. The government sector recorded a net inflow of other capital of CZK 7.1 billion, associated mainly with the de-blocking of long-term assets in Russia and the drawdown of an EIB loan. The business sector saw a net capital inflow of CZK 32.3 billion. The renewed net inflow of other capital into the corporate sector is mainly associated with a rise in businesses' short-term import liabilities and with a long-term loan drawn by power company ČEZ for planned foreign acquisitions.

The net capital outflow through the banking sector amounted to CZK 93.0 billion. This was exclusively outflow of short-term capital. About one-third was attributable to a rise in short-term assets, koruna assets in particular, which may have been associated with the government bond issue abroad and with the financing of domestic share purchases by non-residents. A decline in the foreign currency liabilities of the banking sector accounted for the remaining two-thirds.

In 2004 Q4, the CNB's international reserves were again affected primarily by valuation changes. On the basis of a decision made by the Bank Board in April, the CNB continued to sell off the income on these reserves (about CZK 2.9 billion). In 2004 Q4, the reserves fell by CZK 47.3 billion to CZK 636.3 billion in koruna terms and increased by USD 1.6 billion to USD 28.4 billion in dollar terms. During 2004, they decreased by CZK 55.2 billion in koruna terms and increased by USD 1.5 billion in dollar terms.

CHART III.15.

The international reserves increased in dollar terms in 2004 Q4

(USD billions)

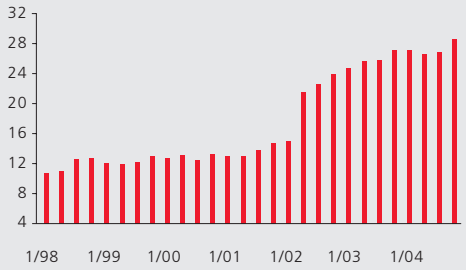


TABLE III.2.

Annual M2 growth slowed in 2004 H2

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

	I/04	II/04	III/04	10/04	11/04	Out-standing amount as a perc. of M2 11/04
M1	14.7	15.6	12.7	10.1	9.9	53.0
Currency in circulation	10.7	8.9	7.7	7.0	6.1	13.0
Overnight deposits	16.0	18.0	14.4	11.2	11.2	40.1
M2–M1 (quasi money)	0.1	3.2	3.3	5.3	3.0	47.0
Deposits with agreed maturity	2.0	4.7	3.7	6.4	2.8	36.3
Dep. bills of exch. and other bonds	38.5	47.7	29.1	34.0	21.9	6.1
Deposits redeemable at notice	-5.0	-3.5	-1.1	1.8	3.6	10.1
Repurchase agreements	-19.3	95.6	75.7	-2.3	8.2	0.5
M2	7.0	9.2	8.0	7.8	6.6	100.0

III.4. MONEY AND CREDIT

Despite a slowdown in growth in the second half of last year, money growth was in line with economic growth expectations and again indicated higher growth in investment than in consumption. The share of M1 in M2 was high, confirming the easy interest rate conditions. Favourable financing conditions encouraged demand by non-financial corporations for investment loans, but bank overdrafts for financing corporate operating needs grew as well. The growth rates of credit to non-financial corporations differed across the individual branches of the economy. Growth in loans to households remained buoyant, with mortgage loans still predominating. A slight upswing was also recorded for consumer credit. At the longer-term horizon, however, their growth moderated, again confirming lower growth in consumption expenditure at the end of last year.

III.4.1. Money

M2 growth slowed to 8% in 2004 Q3. This trend continued into November 2004 (see Table III.2.). Nonetheless, M2 growth remains quite high at the long-term horizon, which is in line with economic growth expectations. It is also consistent with GDP growth in the current period, owing to the increased volumes of money held by economic agents to finance their economic activities (see Chart III.16.).

Within M2, the monetary aggregate M1 still has the largest share, although its annual growth rate decreased to 12.7% in 2004 Q3 and to 9.9% in November 2004. The share of M1 in M2 remained at a two-year high (53%) thanks to the easy interest rate conditions. The falling M1 growth was apparent in both currency in circulation and overnight deposits. The declining growth of currency

CHART III.16.

M2 growth was in line with GDP growth

(annual percentage changes)

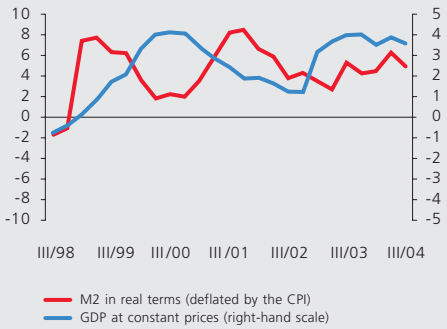


TABLE III.3.

The upturn in lending to non-financial corporations continued

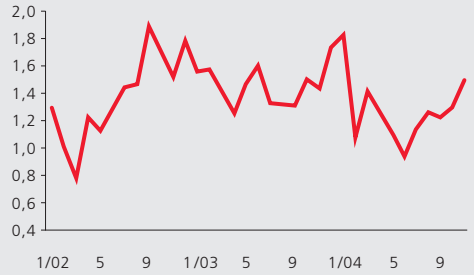
(quarterly averages and end-of-month stocks; annual percentage changes)

	I/04	II/04	III/04	10/04	11/04
Loans up to 1 year	-1.7	1.5	12.9	20.3	13.2
Loans over 1 year and up to 5 years	-5.0	3.0	7.2	9.8	8.3
Loans over 5 years	-1.6	2.4	5.6	9.9	6.4
Loans to non-financial corporations, total	1.1	2.5	0.3	4.5	1.4

CHART III.17.

Despite increasing, the spread between the interest rate on loans to non-financial corporations with maturities up to 1Y and the 1Y PRIBOR remained relatively low

(percentage points)



in circulation and overnight deposits of households was consistent with slackening growth of household consumption. The growth of overnight deposits of non-financial corporations remained at a higher level than that of households, despite decreasing to 15.5% in the period under review.

The growth of quasi-money continued into 2004 Q3 and on into November. This growth manifested itself in households' deposits redeemable at notice. By contrast, the growth of deposits with agreed maturity fell in Q3, although it accelerated for the year as a whole, particularly in the case of households. Nonetheless, it is still much slower than that of overnight deposits, owing to the low interest rate levels. In November, the interest rate on new overnight deposits was 0.5% for households and 0.7% for non-financial corporations, and the rate on new deposits with agreed maturity was 1.5% for households and 2.1% for non-financial corporations.

III.4.2. Credit

Growth in loans to corporations and households increased by 1.2 percentage points to 12.2% in 2004 Q3. In November 2004 it remained at a similar level. The pick-up in growth of loans to non-financial corporations was associated with the rise in investment in Q3. Corporations sought investment loans with long maturities, but short-term loans also increased in the period under review. As regards ownership structure, credit growth was recorded for both domestic and foreign-controlled corporations in Q3.

New loans to non-financial corporations of greater than CZK 30 million (i.e. loans probably provided to large businesses) made up a significant proportion of new loans in the period under review. After a rise in 2004 H1, however, this proportion decreased to 40.5%. The share of new loans of up to CZK 30 million (i.e. loans provided mostly to small and medium-sized enterprises) decreased throughout last year, to 12.4%. Bank overdrafts made up another part of the total.

As regards the fixation of interest rates on new loans to non-financial corporations, loans with short-term rate fixation and bank overdrafts had the largest weights (46.9% and 47.1% respectively). This increases corporations' sensitivity to interest rate changes in the period ahead. The second half of last year saw an increase in the share of bank overdrafts, indicating that the corporations needed external funds to secure their operating needs. It might also have meant that the forewarned greater supply of loans to small and medium-sized businesses materialised.

The financing conditions of non-financial corporations remained favourable in 2004 Q3 thanks to the easy interest rate conditions. This situation continued into November 2004. The spread between the interest rate on loans to non-financial corporations with maturities of up to one year and the 1Y PRIBOR, representing the risk premium in any given phase of the business cycle, increased slightly (see Chart III.17.), but remained quite low owing to the improved financial condition of corporations.

In 2004 Q3, the share of loans in corporations' external funds increased year on year (from 26.5% in 2003 Q3 to 27.2% in 2004 Q3), thereby increasing the significance of loans in the financing of corporations' economic activities. This was associated with the phase of the business cycle, as a pick-up in economic

growth accompanied by investment growth fosters corporate demand for credit (see Chart III.18.). In 2004 Q3, some non-financial corporations continued to increase their equity, thanks to higher profits. The share of equity in the liabilities of corporations reached 52% (against 51.7% in 2003 Q3). The share of equity in the external funds of non-financial corporations was 1.08% (almost unchanged year on year).

The growth in loans to households remained high. These loans were up by 31.4% in 2004 Q3 and 33% in November. Mortgage loans again accounted for the largest proportion (18.2 percentage points). Households' demand for loans reflected the easy interest rate conditions and the increased supply of loans from monetary financial institutions[12].

The rise in housing loans moderated in 2004 Q3, but remained high at about 35% (see Table III.5.). This may be linked, among other things, with a stagnation of residential property prices following the Czech Republic's entry into the EU. In November, mortgage loans accounted for 59.6% of housing loans and their rate of growth was 52.3%. The interest rate on new housing loans increased slightly, to 5.3%. However, it remains at a low level and is supporting households' demand for credit. The rate on loans with an initial rate fixation of over one and up to five years also increased in Q3, but was flat in October and November, at 5.3%. These loans account for the largest share of new housing loans (48.5%), which increases households' sensitivity to mortgage rate changes in the period ahead, since the maturity of these loans exceeds five years.

Consumer credit to households showed annual growth of 22% in 2004 Q3. This growth continued into October and November, although it was slower at the longer-term horizon, thus being consistent, for last year as a whole, with the slowing growth in the consumption expenditure of households. Other loans to households, which tend to be loans to sole traders, increased further in 2004 Q3. This may also reflect the forewarned lending to small businesses by monetary financial institutions.

In 2004 Q3, the strong growth in loans to households affected overall household debt (i.e. loans from monetary financial institutions, hire-purchase and other forms of financing). The ratio of total outstanding debt to the gross disposable income of households was about 22%. The ratio of household debt to GDP was about 12% (compared to the equivalent EU average of 55%). The ratio of interest expenses to gross disposable income of households remained at 1.9% thanks to the low interest rates.

Box

The structure of lending

There was a pick-up in annual total credit growth in 2004. The trend, however, differed across the individual branches of the economy (see Table 1.). The main contributors to the growth were loans granted to non-financial corporations in manufacturing, loans to the trade, sales, maintenance and repairs category, loans

12 Monetary financial institutions include the central bank, resident banks and any other resident monetary financial institutions (money market funds and credit unions). Non-monetary financial institutions include resident investment companies, investment funds, insurance companies and leasing companies.

TABLE III.4.

Credit was the biggest growth item of corporate external funds

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

	I/04	II/04	III/04	Outstanding amount as a perc. of total liabilities III/04
Equity	4.2	4.9	6.1	52.0
External funds (liabilities – equity)	2.0	5.0	5.0	48.0
Reserves	4.6	-0.8	-0.9	3.7
Bonds and bills	24.6	3.9	4.9	5.1
Credit and loans	0.6	7.2	7.9	13.1
Other liabilities	-1.4	4.9	4.4	26.1
Liabilities	3.1	5.0	5.6	100.0

CHART III.18.

The importance of loans in financing the economic activity of non-financial corporations increased

(annual percentage changes)

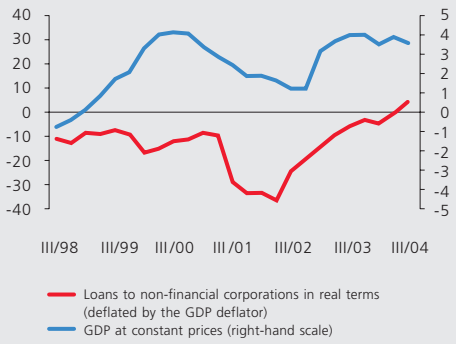


TABLE III.5.

The rate of growth of loans to households remained high, with housing loans still predominating

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

	I/04	II/04	III/04	10/04	11/04
Housing loans	40.1	39.0	35.4	34.7	35.1
Consumer credit	20.5	18.7	22.0	19.6	25.5
Other loans	2.6	18.5	28.3	32.6	35.4
Loans to households, total	30.5	31.4	31.4	31.3	33.0

TABLE I. (Box)

Growth in loans varied across the individual branches

(end-of-month stocks; annual percentage changes)

	I/04	II/04	III/04	10/04	11/04	Outstanding amount as a perc. of total loans 11/04
Agriculture, hunting, fishing	6.3	15.7	17.3	14.9	14.1	2.1
Forestry and logging	-13.8	21.1	15.1	14.1	1.8	0.1
Mining and quarrying	-12.9	-17.8	-23.7	-27.4	-20.9	0.6
Manufacturing	-0.7	1.1	4.6	4.4	3.7	14.8
Electricity, gas and water supply	-2.6	-0.7	5.6	6.4	1.4	3.0
Construction	-2.9	10.3	19.8	8.8	21.8	1.7
Wholesale and retail trade, sales, maintenance, repairs	2.0	1.7	1.8	3.8	7.0	11.2
Hotels and restaurants	-4.0	-1.3	11.5	4.8	1.6	0.5
Transport and storage	-12.2	-8.8	-13.1	-10.5	-9.0	2.0
Communication	51.3	53.9	85.1	129.3	-35.1	1.0
Financial intermediation	-4.5	-15.1	-19.7	-20.4	-22.1	14.6
Insurance	111.5	89.6	99.4	90.6	8.7	0.7
Renting of machinery and equipment	15.6	29.8	34.2	33.9	30.8	9.5
Other market services	0.8	27.8	27.7	27.2	22.1	2.7
Other activities	21.2	22.4	21.5	21.5	22.3	35.5

CHART 1. (Box)

The branches that contributed most to the growth in loans were also the main sources of GDP growth

(percentage points)

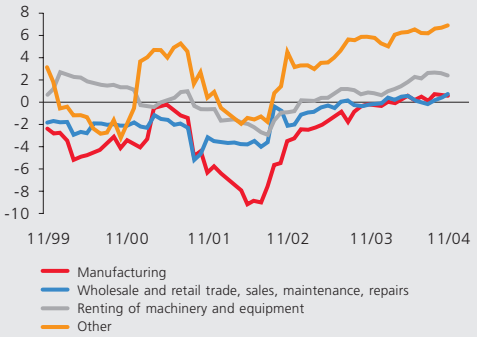
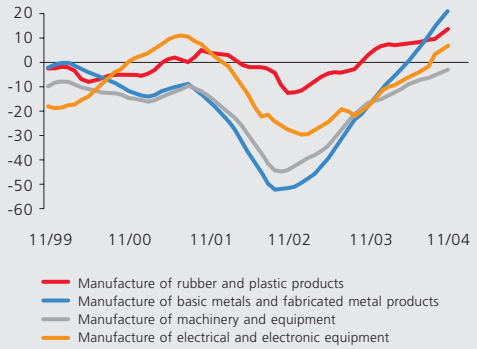


CHART 2. (Box)

Within manufacturing, loans grew in branches with a high share of direct export sales in sales from industrial activity

(annual moving averages; percentages)



for renting of machinery and equipment and loans to other branches, accounting for 73% of loans to households (see Chart 1.). The above branches were also the main sources of fixed capital formation in 2004 Q1—Q3. The contributions of the other branches to the annual growth in lending were less significant or caused a decrease in loans. The less significant branches, which, however, recorded relatively high growth rates, included agriculture, electricity, gas and water supply, and construction. By contrast, financial intermediation, comprising *inter alia* financial leasing institutions, fostered a decline in lending.

Following a sizeable decline in past years, loans to manufacturing staged a recovery in 2004, rising by 3.7% year on year in November and accounting for 14.8% of total loans, the second largest figure within the classification of loans by branch. The biggest increases in loans to non-financial corporations were recorded in the manufacture of rubber and plastic products, the manufacture of basic metals and fabricated metal products, the manufacture of machinery and equipment and the manufacture of electrical and electronic equipment (see Chart 2.). These branches, together with the manufacture of transport equipment (financed primarily from internal and other external funds), had the largest share of direct export sales in sales from industrial activity and increased their tangible and intangible fixed assets. Besides loans, non-financial manufacturing corporations last year increased their equity, which was up by 12.1% in 2004 Q3 on a year earlier. However, its volume was still low relative to external funds (at 0.88%), indicating the significance of external funds in the financing of these corporations.

Last year also saw an upswing in loans provided to the trade, sales, maintenance and repairs category, which rose by 7% year on year in November. These include loans to wholesale and retail trade, loans for maintenance and repair of motor vehicles, etc. The growth in lending to this industry was accompanied by a pick-up in corporate equity growth (11.1%). Its share of external funds amounted to 0.53% in 2004 Q3.

Loans provided for the renting of machinery and equipment grew by 30.8% in November, up by almost 50% on the start of 2004. These include loans sought by non-financial corporations primarily for financing the renting of cars, light delivery vehicles and other vehicles (trucks etc.). In the category of renting of machinery and equipment, the credit growth was accompanied by a lower rate of growth of corporate equity (7.4%). In Q3, the share of equity in external funds thus fell somewhat, to 0.65% year on year.

The credit structure suggested that the pick-up in credit growth recorded for non-financial corporations differed across the individual branches and was not always accompanied by higher equity formation. Loans recorded an upturn chiefly in branches which were significant in 2004 Q1—Q3 with respect to GDP formation. These were mostly branches with a higher proportion of external funds in their liabilities structure, which, in the given phase of the business cycle, manifested itself in demand for credit.

III.5. DEMAND AND OUTPUT

According to the CZSO's revised data[13], the relatively stable economic growth visible since the start of 2003 continued into 2004 Q3. Compared to the previous quarter, annual GDP growth moderated slightly, to 3.6% (3.7% for the first three quarters of 2004). This moderation was partly due to a decrease of three in the number of working days compared to the same period of 2003. According to the CNB's estimates, actual economic output was still below the potential output level, but the output gap was now only slightly negative[14].

The main causes of the continuing economic growth are the same as in the previous two quarters. The primary factor was the continuing external demand recovery, which created favourable conditions for Czech exports. The rapidly rising real exports and the positive external demand outlook, supported by high growth in orders from abroad, in turn stimulated investment decision-making. Other factors facilitating the investment decision-making process included growth of own funds and the easy monetary conditions. Total investment growth was also affected by foreign direct investment and expectations of tax changes in the household sector.

Investment was again the fastest-growing component of domestic demand. By contrast, consumer demand growth slowed further, although the contribution of household consumption expenditure to GDP growth remained significant. Neither government expenditure on final consumption nor changes in inventories supported GDP growth in Q3. There was a change, however, in the external sector, where, after a long period of negative figures, the contribution of foreign trade transactions to GDP growth was positive, thanks to much higher export growth than import growth.

III.5.1. Domestic demand

Total domestic demand growth eased in 2004 Q3. The main factor underlying the greater slowdown in annual growth (to 2.4%) was final consumption expenditure, which in Q3 fell short of the level of the same period a year earlier. This was due to a combined effect of a larger annual decline in government expenditure on final consumption and weaker consumer demand growth. The change in inventories was also less than a year earlier[15]. Domestic demand growth was thus supported above all by rapidly rising investment demand, whose year-on-year growth rate was almost 10%, despite falling slightly in Q3.

Investment demand

According to the CZSO's revised data, the strong investment demand growth persisted in 2004 Q3. The annual gross fixed capital growth of 9.7% was only just below the five-year high recorded in the previous quarter (10.5%). The continuing strong growth in investment was confirmed not only by the indicators

13 The CZSO harmonised the 2003 quarterly national accounts with the preliminary national accounts figures for 2003. As a result, the GDP growth figure for 2003 at constant prices was revised from 3.1% to 3.7% and the estimate of GDP growth for 2004 Q2 from 4.1% to 3.0%.

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

15 The real change in inventories in 2004 Q3 was only 78% of that in the same period a year earlier.

CHART III.19.

Economic growth of over 3.5% continued into 2004 Q3

(annual percentage changes)

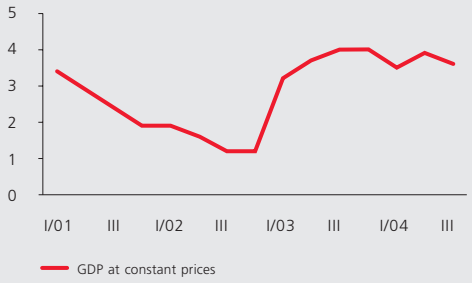


CHART III.20.

The GDP growth was linked chiefly with buoyant investment demand, stimulated by a surge in external demand

(annual percentage changes; constant prices)

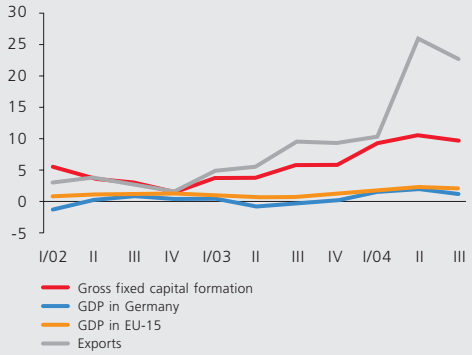


TABLE III.6.

The contribution of the fast-growing investment demand to GDP growth in 2004 Q3 was greater than that of consumer demand

(annual percentage changes)

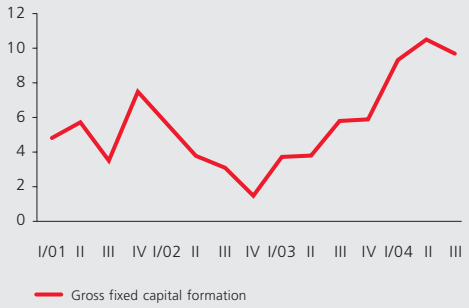
	Q1/03	Q2/03	Q3/03	Q4/03	Q1/04	Q2/04	Q3/04
Gross domestic product	3.2	3.7	4.0	4.0	3.1	3.9	3.6
Aggregate demand (domestic demand and exports)	4.2	5.3	6.1	6.2	5.3	13.6	10.9
Total domestic demand[a]	3.7	5.1	3.8	3.9	4.6	4.5	2.4
Final consumption expenditure	4.7	5.1	4.8	4.2	5.1	1.5	-0.3
of which:							
Household consump.	4.9	5.2	5.5	4.1	4.9	2.5	2.0
Government consumption	4.5	5.0	3.3	4.0	2.2	-0.8	-5.5
Non-profit institutions serv. households	-1.4	2.6	2.4	10.4	3.2	10.1	11.9
Gross fixed capital formation	3.7	3.8	5.8	5.9	7.4	10.5	9.7
Imports of goods and services	5.6	7.4	8.9	9.6	9.5	25.8	19.3
Exports of goods and services	4.9	5.6	9.5	9.3	6.2	26.0	22.7
Net exports of goods and services (CZK billions)	-40.5	-52.2	-58.2	-78.1	-215.3	-64.8	-57.7

a) including changes in inventories

CHART III.21.

Annual investment growth fluctuated around 10% for the second consecutive quarter

(annual percentage changes)



of investment demand in individual sectors, but also by the evolution of production, construction and import investment activity in 2004. Since revised data on the investment structure have not yet been published, the evaluation of trends in this area is based on partial indicators.

Household investment appeared to continue growing in 2004 Q3. This was suggested above all by a relatively high year-on-year rise in the number of housing completions (10.9%). The hypothesis of persisting household demand for housing investment was also supported by the indicators of sources of investment financing, in particular the continuing surge in housing loans[16] (for details see section III.4. *Money and credit*). Investment demand in this sector was stimulated primarily by expectations of VAT changes in 2007 and by favourable conditions for taking out mortgage loans (including the current level of interest rates), reflected in a fairly strong supply of housing on the part of construction firms.

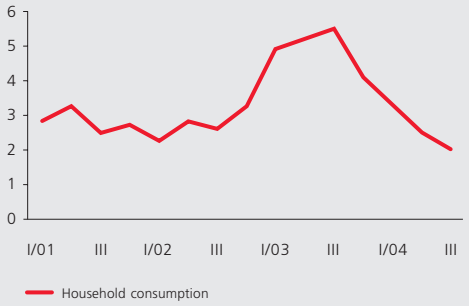
Investment in the sector of non-financial organisations and corporations picked up considerably. This assumption is based on data showing very buoyant year-on-year investment growth in monitored large companies[17] in 2004 Q3 (of 15.1%). These companies account for more than half of total investment in the non-financial corporations sector. This growth was due to positive demand expectations and, as regards sources of financing, was fostered not only by favourable own funds growth, but also by rising investment lending by commercial banks. The fastest growing investments were again those made by foreign-controlled corporations (in both production and non-production facilities). By contrast, the contribution of government sector investment to total investment growth probably fell year on year in 2004 Q3 compared to Q2, because of an annual decline (of around 4%) in state budget and municipal budget capital expenditure.

Consumer demand

CHART III.22.

The downward trend in real consumption expenditure growth continued

(annual percentage changes)



Consumer demand growth continued to slacken in 2004 Q3. This trend, visible since 2003 Q3 according to the CZSO's revised data, culminated in relatively low annual growth of 2% in 2004 Q3. As in the previous quarters of 2004, the slowing growth in households' real consumption expenditure was primarily a reaction to declining growth in their real disposable income.

Households' gross disposable income growth was fairly even in the first three quarters of 2004. The year-on-year growth rates were in fact somewhat higher (at around 4%) than in 2003. The gross disposable income growth figure of 4.3% recorded in Q3 was mostly due to income from wages and salaries, which is the largest component of household income. Other income showed quite mixed developments in Q3. After extraordinarily high growth in Q2, the rate of growth of social benefits saw a sizeable decline[18]. Property income also showed lower growth, due to a fall in the distributed income of corporations.

16 Mortgage loans and loans granted by building societies.
17 i.e. corporations with 100 employees or more.
18 i.e. social benefits other than social transfers in kind.

Although households' nominal disposable income grew faster than in 2003, the real annual growth did not exceed 2% in the first three quarters of 2004. Owing to higher annual inflation compared to the previous year, real disposable income grew more slowly in 2004 (by just 1% in 2004 Q3; see Chart III.23.). Faster growth in households' real consumption expenditure than in their real disposable income (by 1 percentage point) resulted in lower household saving compared to 2003[19]. At the same time, households also used consumer credit to finance their consumption expenditure (for details see section III.4. *Money and credit*).

Overall, households' consumption behaviour in the first three quarters of 2004 was more moderate than in 2003, when low or falling inflation and low interest rates had encouraged households' propensity to consume.

Government demand

Final consumption expenditure by general government decreased by 5.5% year on year in real terms in 2004 Q3, a much deeper decline than in the previous two quarters. At current prices, final government consumption rose by about 3%.

The government demand analysis is based primarily on data on the state budget performance, which cover a large part of the developments in the government sector as a whole. In 2004 Q3, the state budget was characterised by quite high annual growth in nominal revenues (of over 10%) and an equally large fall in expenditure (of about 9%). The result was a state budget surplus of over CZK 9 billion, as against a deficit of almost CZK 27 billion in 2003 Q3.

On the revenue side, dynamic growth was recorded for collection of indirect taxes, with VAT and excise duty revenues up by around 20% thanks to tax changes associated with EU accession and the public finance reform. The decline on the expenditure side of the state budget was due mainly to a large fall in non-investment transfers to local budgets and national funds, which, however, do not affect government sector demand, and to a large (almost 7%) fall in other current expenditure on materials, repairs and maintenance. Nominal growth in public employee wage expenditure was relatively low in the period under review, at roughly 3.6%. Overall, then, the state budget figures suggested that the government sector did not contribute to demand growth in the economy in 2004 Q3. This view is consistent with the CZSO's aforementioned figures on falling final consumption expenditure by general government.

III.5.2. Net external demand

The continuing modest recovery of economic growth abroad again helped to improve the conditions for Czech exports. This was reflected in further growth in the export activity of domestic producers. Export growth fell somewhat in 2004 Q3, but was still quite high (22.7% year on year). Given the high import intensity of Czech GDP, imports also recorded rapid growth (19.3%). However,

CHART III.23.

The slower household consumption growth was due mainly to high inflation eroding the purchasing power of households' income

(annual percentage changes)

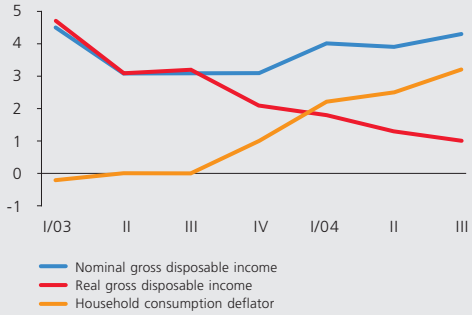


CHART III.24.

The annual decline in government final consumption expenditure deepened at the end of 2004

(percentages)

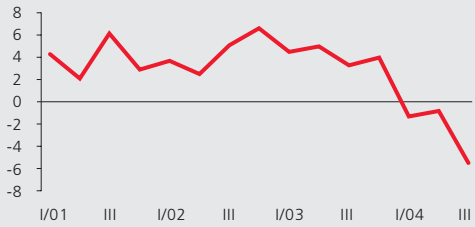


CHART III.25.

Export growth was markedly higher than import growth in 2004 Q3

(annual percentage changes; 1995 constant prices)

19 According to the CZSO, gross saving decreased by 9.1% year on year in 2004 Q3. The savings rate fell to 6%.

CHART III.26.

The adverse trend in negative net exports halted in 2004 Q3

(CZK billions; constant prices)

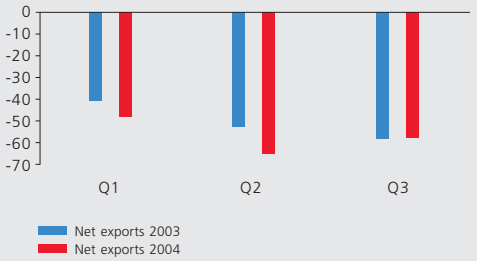


CHART III.27.

Trade, services and industry were the biggest contributors to GDP

(2004 Q3; selected components at basic prices)

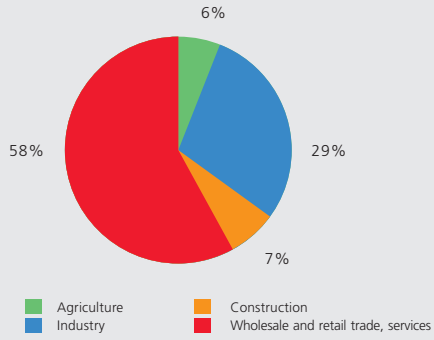
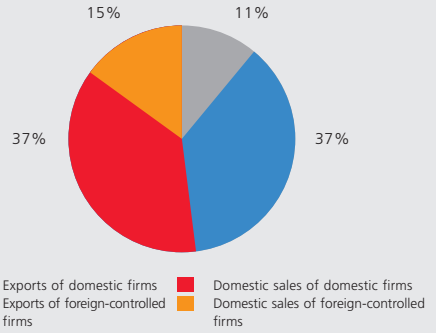


CHART III.28.

Exports continued to account for almost half of industrial firms' sales

(shares in total industrial sales — domestic and external — at constant prices; 2004 Q3)



import growth slowed more markedly than export growth year on year. Exports consequently grew much faster than imports in this quarter. As a result, the unfavourable trend in net exports of goods and services witnessed for the last nine quarters halted. Net exports fell by CZK 0.5 billion year on year to CZK -57.7 billion, and their contribution to GDP growth moved into slightly positive figures (0.1 percentage point).

The year-on-year improvement in net exports was due solely to a better trade balance. The trade deficit narrowed by CZK 7.4 billion, whereas the real services deficit increased further in Q3 (by CZK 3.8 billion). The main factor behind the more favourable trade balance, and hence also net exports, was the upturn in external demand growth and the related increase in goods exports (24.6%). New export-oriented production facilities and the Czech Republic's accession to the EU — linked with better opportunities for exporting Czech goods to EU countries — also had a positive effect. On the other hand, the continuing high year-on-year rate of growth of goods imports (20.2%) stemmed chiefly from high imports for intermediate consumption, as in the previous quarter. Imports for final consumption also rose briskly, and growth in capital goods imports — driven by the high domestic investment demand — was quite strong as well.

III.5.3. Output

On the supply side of the economy, according to the CZSO's estimates, the GDP developments were very mixed, but branches recording annual growth in gross value added still prevailed. A major change was recorded in the primary sector, where the previous long-running year-on-year decline in gross value added was replaced in Q2/Q3 by strong annual growth. Renewed value added growth was registered in agriculture and fishing, and also in mining and quarrying, clearly reflecting higher demand for coal. Particularly important as regards total GDP, however, was that value added continued rising in industry and services, which are the biggest contributors to GDP.

In manufacturing, annual gross value added growth slowed sharply in 2004 Q3 (to 4.9%). As manufacturing accounts for roughly one-third of GDP, this change was one of the main causes of the slower overall GDP growth on the supply side[20]. The continuing growth in manufacturing was again due to several factors, particularly the launching of new production facilities, high domestic investment demand growth, a continuing boom on the iron and steel market, an upswing in demand in the electrical engineering industry and sizeable overall year-on-year real export growth (direct export sales rose by 15.7%). Exports again 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 electrical and optical equipment and machinery and equipment. By contrast, the effect of the high domestic investment demand was indicated by the structure of industrial production by use — production of investment products again showed the fastest growth (13.6% year on year). The above factors fostered continuing major structural changes in industry.

20 The slower growth was also partly due to a lower number of working days in Q3 (three days less than in 2003 Q3).

Value added growth in the services sector was also very mixed in 2004 Q3, but most of the highest-weight segments recorded continuing growth. However, the long-running upward trends seen in real estate services, services for businesses, research and development and hotels and restaurants were interrupted in 2004 Q3. Value added in construction also recorded a year-on-year decrease.

III.5.4. Financial performance of non-financial organisations and corporations[21]

The continuing economic growth, accompanied by high export growth, again had a favourable effect on the financial results of large non-financial organisations and corporations in 2004 Q3. Annual income growth was slightly lower than in Q2, but remained strong (about 11% year on year). Expenses grew more slowly, so the overall pre-tax profit of large firms continued to show high annual growth (37%). In the first three months of 2004 this profit grew by 24%.

Annual rises in the profit-expenses and profit-equity ratios at the same time suggested that the persisting external cost pressures generated by the high growth in prices of energy-producing materials and metals on world markets was not causing a major deterioration in corporate performance. The material cost-output ratio increased in year-on-year terms, but this increase was offset in part by a decrease in the personnel cost-output ratio and, in the case of exporters, by favourable terms of trade. The fact that corporate economic performance did not worsen across the board in the period under review was also indicated by the structure of profit margins, which increased year on year in most branches during the first three quarters of 2004 (in the broader aggregation the only decrease was registered by public non-financial corporations).

When analysing the impact of the rising prices of external inputs on corporate financial performance, one should, however, consider whether, and to what extent, corporations reflected these cost pressures in their producer prices. As mentioned in section III.7. *Import prices and producer prices*, producers reacted to the external cost shock by increasing their prices in branches engaged directly in processing imported raw materials and the semi-manufactures made from them, and in the chemical industry. These price changes fully offset the rise in prices of external inputs, as the annual rate of growth of the net operating surplus was high in the first three quarters of 2004 and the profit margin increased as well (for example, in basic metals and fabricated metal products it rose by 2.4 percentage points).

The fact that in most other branches of industry prices continued to grow modestly or were still falling year on year, suggested that there were numerous other factors delaying and softening the transmission of the rising prices of imported raw materials into producer and consumer prices. A major factor was the level of consumption of these raw materials in the individual production areas[22]. A major role is also played by the number of stages of processing of a raw material prior to its use in the manufacture of the final product. As the structure of producer price inflation suggests, the effects of the current external cost shock

TABLE III.7.

High profit growth was achieved in the first three quarters of 2004

(annual percentage changes)

	2004 Q1—Q3	
	Organisations, total	Industry
Income, total	10.5	12.6
Output, total	13.6	14.3
Expenses, total	9.7	11.7
of which:		
cost of sales	14.2	14.5
personnel costs[a)]	7.1	6.0
depreciation	2.3	3.3
Book value added	12.2	13.9
Pre-tax profit	24.0	25.2
Net operating surplus	30.2	33.6

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 offset by a falling personnel cost-output ratio

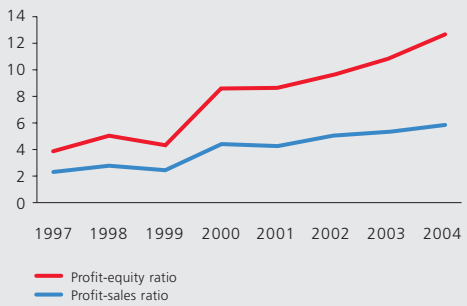
(percentages; percentage points; CZK thousands)

	Q1—Q3 2004		Change in perc. points against Q1—Q3 2003	
	Organisations, total	Industry	Organisations, total	Industry
Profit-expenses ratio	6.92	8.17	0.80	0.88
Profit-equity ratio	11.35	12.82	1.64	1.69
Profit-sales ratio	7.11	8.35	0.58	0.70
Material cost-output ratio	69.70	73.21	0.39	0.11
Personnel cost-output ratio	14.74	11.62	-0.90	-0.92
Ratio of wage costs to value added	48.64	43.39	-2.30	-3.23
	CZK thousands per month		annual percentage changes	
Book value added per employee	51.81	57.32	12.70	15.60

CHART III.29.

Fast-growing earnings generated a higher profit-equity ratio

(percentages; 2004 = annualised values for 2004 Q1—Q3)



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

22 For example, consumption of gas and electricity accounted for around 4% of output consumption in the first three quarters of 2004.

CHART III.30.

On the labour market, the gap between labour supply and demand narrowed further

(annual percentage changes and percentage point changes)

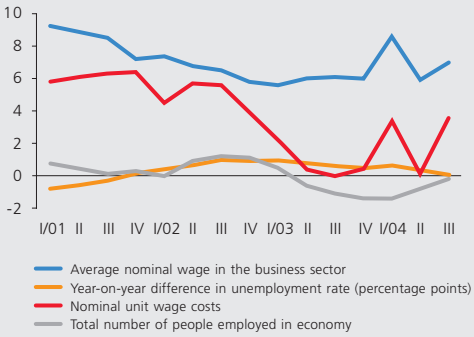


CHART III.31.

The upturn in labour demand was indicated by renewed year-on-year growth in the number of employees in 2004 Q3

(annual percentage changes)

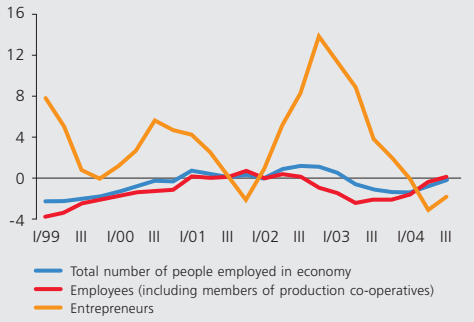


TABLE III.9.

The renewed growth in labour demand was visible in industrial branches enjoying stronger demand for their output

(annual percentage changes; selected branches)

	2004 Q1	2004 Q2	2004 Q3
Industry, total	-1.6	-0.8	-0.2
of which:			
Manufacturing	-1.3	-0.5	0.3
of which:			
manufacture of electrical and optical equipment	3.6	4.6	6.6
manufacture of rubber and plastic products	5.0	6.4	6.3
manufacture of textiles and textile products	-8.2	-8.4	-8.1
manufacture of leather and leather products	-3.2	-6.5	-9.5
manufacture of wood and wood products	-2.0	-1.7	-0.1
manufacture of chemicals and chemical products	-3.3	-3.5	-4.1
manufacture of transport equipment	0.3	1.7	3.3

are not yet visible in the prices of more sophisticated products, for instance. Another factor that should not be overlooked is the strong competition on the market, which is putting pressure on producers to cope with their rising costs by streamlining their production activities.

The favourable financial performance in 2004 Q3 helped to reduce the number of loss-making corporations (by 19% year on year). With regard to ownership structure, output and profit generation continued to rise fastest in foreign-controlled corporations. In the first three quarters of 2004, these corporations accounted for 50.3% of the total output and 60.2% of the profit of the corporations monitored.

III.6. THE LABOUR MARKET

The trend of a gradual narrowing gap between the supply of, and demand for, labour, supported by continuing economic growth and foreign investment inflows, continued into 2004 Q3 and Q4. These factors fostered a change in trend for the main labour market indicators — the previous deepening decline in the number of employed people was replaced by a gradual moderation, and at the end of 2004 the registered unemployment rate stopped rising and was the same as a year earlier. A more marked increase in the number of employed people and a corresponding fall in the unemployment rate were prevented by persisting structural unemployment in terms of skills and regions, reflected in long-term unemployment. Growth in average wages and total wage volumes picked up further. Productivity growth eased, however, and annual nominal unit wage cost growth thus returned to the higher level recorded at the start of the year. This growth was not across the board in nature, however, as nominal unit wage costs in industry continued falling in year-on-year terms.

III.6.1. Employment and unemployment

A continuing weakening of the negative tendencies on the labour market was confirmed in 2004 Q3 by most of the employment and unemployment indicators. Above all, the annual fall in employment, which had already reached very low figures in 2004 Q3, eased further (by 0.2%, or 10,500 people, according to the LFS). Employment developed more favourably in the employees category, where the long-running year-on-year decline visible since 2002 was replaced by very modest growth (of 0.1%). The number of entrepreneurs continued falling year on year, but the Q3 developments suggested a halt in the unfavourable trend visible since the start of 2003 (Chart III.31.)[23]. A gradual upturn in labour demand was also indicated by a continuing rise in the number of vacancies, which further strengthened in Q4[24].

The narrowing imbalance on the labour market was largely due to the continuing relatively stable growth of the Czech economy, supported by rising domestic and external demand. The improvement in employment was also due to government measures leading to the creation of new FDI-related jobs. These factors fostered a

23 This was due, among other things, to changes in the tax laws which entered into force in 2004.

24 According to the latest data for December 2004, labour offices registered 11,000 more vacancies than in December 2003.

year-on-year increase in employment in a number of branches of industry and services and in construction. As in the previous quarters, however, the labour market was affected by counteracting factors. These included above all the continuing process of adjustment of producers in some branches to the strongly competitive environment. This influence was apparent, for example, in the textile and clothing industry, where Asian competition put pressure on domestic producers to cut costs.

Employment in industry was still decreasing overall in 2004 Q3, but the decline was much smaller than in Q2 (down by 0.6 percentage point) thanks to a recovery of labour demand in some branches. The number of employees in the services sector, which accounts for more than half of total employment, recorded a modest rise. As in industry, however, the developments in this sector were quite mixed.

The recovery in labour demand, as indicated by higher growth in vacancies, only partially helped to reduce unemployment. A larger decrease in the number of unemployed was prevented by high structural unemployment, reflecting skills and regional gaps between the supply of, and demand for, labour (see Chart III.32.). Under these circumstances, the registered unemployment rate did not decrease in 2004 Q4, but remained at the level of the same period of 2003 (10.3% in December). Under the new methodology, it was somewhat lower, at 9.5%[25]. The escalating problem of structural unemployment was also indicated by a persisting relatively high ratio of long-term unemployment (one year or more) to total unemployment, which stood at 51.4% in 2004 Q3 according to LFS figures.

III.6.2. Wages and productivity

In 2004 Q3, average nominal and real wage growth was again faster than in the previous quarter (at 7.3% and 4% respectively year on year). Average nominal wage growth did not exceed the Q1 figures, but was higher in year-on-year comparison. Real average wage growth, however, fell short of the previous year's level, since annual inflation was much higher than in 2003 (see Table III.10.).

The uneven wage growth during the first three quarters of 2004 was attributable to both of the sectors monitored. The larger fluctuations in the rate of growth in Q1 and Q2 were mostly due to extraordinary factors[26]. The wage growth in both the business and non-business sectors in 2004 was also affected by tighter conditions for claiming sick benefits. These new rules probably led to an increase in the volume of wages paid, particularly in the case of lower-wage employees.

In 2004 Q3, the higher wage growth in the industry segment of the business sector was linked with a pick-up in productivity growth. However, this desirable productivity-wage relationship from the point of view of inflation was not achieved in some other branches in 2004 Q3 (see Chart III.35.).

25 The methodological definition of this new unemployment rate indicator was provided in the October 2004 Inflation Report.

26 For details see the October 2004 Inflation Report.

CHART III.32.

The rise in vacancies was not accompanied by a corresponding fall in the number of people unemployed

(seasonally adjusted numbers in thousands)

CHART III.33.

A stronger rise in employment was prevented by structural unemployment, as indicated by the high long-term unemployment rate

(source: LFS)

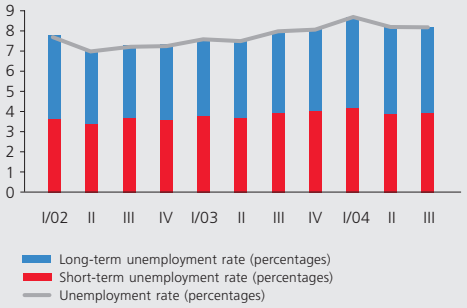


TABLE III.10.

Annual nominal and real wage growth picked up in 2004 Q3

(annual percentage changes)

	03 Q1	03 Q2	03 Q3	03 Q4	03	04 Q1	04 Q2	04 Q3
Average wage in monitored organisations								
nominal	7.2	6.8	6.3	6.9	6.8	8.8	4.3	7.3
real	7.6	6.7	6.4	6.0	6.7	6.3	1.8	4.0
Average wage in business sector								
nominal	5.6	6.0	6.1	6.0	6.0	8.6	5.9	7.0
real	6.0	5.9	6.2	5.1	5.9	6.1	3.2	3.7
Average wage in non-business sector								
nominal	13.9	9.2	7.5	9.7	9.8	9.7	-0.6	8.3
real	14.4	9.1	7.6	8.8	9.7	7.2	-3.1	4.9
Whole-economy labour productivity	3.1	4.5	5.0	5.2	4.5	4.4	4.1	3.5
Nominal unit wage costs	2.2	0.4	0.0	0.4	0.8	3.4	0.1	3.6

CHART III.34.

Annual growth in whole-economy labour productivity has slackened since the start of 2004

(annual percentage changes)

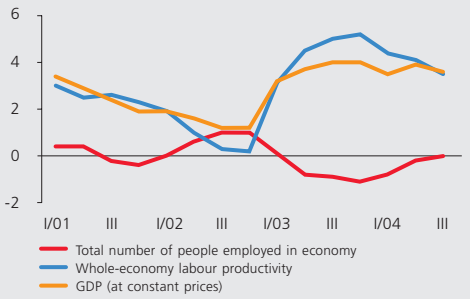


CHART III.35.

The personnel cost-output ratio at the macro-level rose somewhat in 2004 Q3

(annual percentage changes; selected branches)

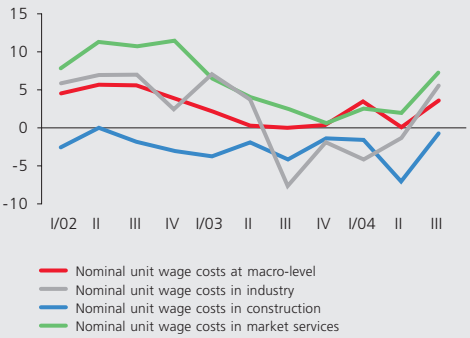
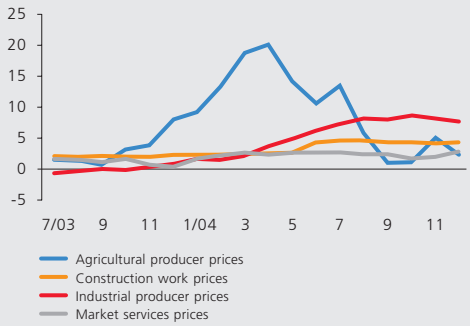


CHART III.36.

The relatively high industrial producer price inflation — linked with high growth in external input prices — fell somewhat at the end of 2004

(annual percentage changes)



As a result, the interaction of wage and productivity variables at the macroeconomic level, indicating a potential build-up of inflationary pressures in this area, suggested a renewed deterioration in Q3 by comparison with the previous quarter. The higher wage growth coupled with the more favourable employment situation generated faster growth in the volume of wages paid. On the other hand, the modest slowdown in GDP growth coupled with the favourable employment situation was reflected in rather slower growth in whole-economy labour productivity (3.5%). These contrary movements in the wage and productivity indicators resulted in renewed nominal unit wage cost growth in Q3 to around the level recorded at the start of 2004 (3.6% year on year).

However, nominal unit wage costs showed quite mixed results in terms of structure. In industry, they continued to fall (by 0.6%), whereas in market services[27] and construction, they showed year-on-year growth. As Chart III.35. shows, nominal unit wage costs in market services are rising faster than in other sectors. However, the larger growth in Q3 was not due to faster wage growth, but to a more marked decline in real sales growth compared to the previous quarter. In construction, the nominal unit wage cost growth in Q3 was short-term in nature, as it resulted from increased invoicing in Q2 prior to the introduction of new VAT rates.

Overall, the evolution of nominal unit wage costs in the first three quarters of 2004 did not indicate any build-up of widespread inflationary pressures. In services, though, some pass-through of the wage-cost pressures into producer or consumer prices cannot be ruled out.

III.7. IMPORT PRICES AND PRODUCER PRICES

Other cost indicators again showed very mixed developments in 2004 Q4, but on the whole they continued to indicate a build-up of inflationary cost pressures in the economy. The main source of these pressures was continuing high growth in prices of some imported commodities, caused by fast-rising prices of key energy-producing materials and some other raw materials on world markets. In Q4, these external effects were bolstered by some factors of domestic origin which affected prices in the mining and quarrying industry. Industrial producer prices recorded the fastest growth. This growth, however, was still being driven by a small number of branches engaged in processing imported raw materials with rapidly rising prices. In most other branches of industry, producer prices showed modest growth or an annual decline. There was also a larger contribution from producer prices in the mining and quarrying industry in Q4. Inflation in the food industry moderated further, thanks to food import prices and agricultural producer prices. Construction work prices were flat year on year at the end of 2004, whereas market services prices rose somewhat.

27 As in industry, the nominal unit wage cost calculations are based on sales at constant prices.

III.7.1. Import prices

Import prices are an important inflation factor in the Czech Republic, owing to the high openness and high import propensity of its economy. Import prices showed no major change in trend in the first two months of 2004 Q4 compared to the previous quarter. The higher growth recorded in October did not continue. On the contrary, annual import price inflation fell back in November to the level of the previous quarters (2.1%).

The rise in import prices was still linked to a large extent with the continuing pick-up in growth of prices of energy-producing materials on world markets, which peaked at the extraordinary figure of 47.7% in October. The growth eased in the following two months, to 31.1% in December[28]. Annual growth in metal prices on world markets also slowed considerably in November and December (to 21.5% in December). Prices of the other commodities included in the CZSO's index of world prices of industrial raw materials and food showed mixed developments. Overall, these prices declined year on year throughout Q4. Owing to considerably slower growth in prices of raw materials, fuels and metals in November and December, the CZSO's annual world price index also fell (to 24.1% in December).

As in the previous quarters of 2004, the mostly buoyant year-on-year growth in world prices of raw materials and food was not fully reflected in import prices. Their impact was largely dampened by the koruna-dollar nominal exchange rate, which has been appreciating strongly year on year since 2004 Q2. This effect was particularly noticeable in prices of imported raw materials, which are paid for in US dollars. The koruna-euro rate has also been strengthening moderately since the start of Q3. In these circumstances, the koruna's exchange rate cushioned the impacts of external prices on domestic prices for almost all imported commodities, albeit to varying degrees.

The differential evolution of external prices of raw materials, food and final products and the koruna's exchange rate passed through with mixed intensity into the individual import categories of the CZSO import goods price index. The concurrent weakening of the annual growth of world prices of raw materials and fuels and the year-on-year strengthening of the koruna-dollar rate in Q4 fostered a considerable fall in the rate of growth of import prices in the raw materials and mineral fuels category. It was also reflected in a fall in the rate of growth of total import prices. However, there were no significant changes in the import price index structure by comparison with the previous Inflation Report. The fastest import price growth was again recorded by raw materials and products with a low degree of processing (energy and non-energy-producing materials and semi-manufactures, particularly those made from metals). By contrast, import prices of products with a high degree of processing continued to record year-on-year declines and food import prices showed only modest growth.

TABLE III.11.

Import prices remained strongly affected by fast-rising prices of raw materials and mineral fuels on world markets

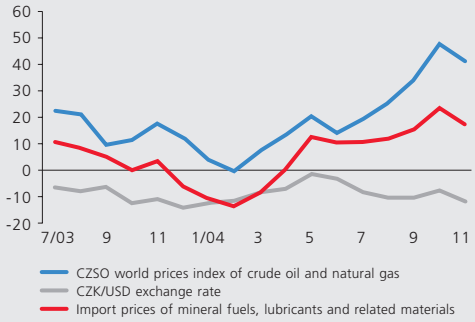
(annual percentage changes)

	6/04	7/04	8/04	9/04	10/04	11/04
Imports, total	2.4	2.5	2.2	2.2	3.3	2.1
Food and live animals	3.7	4.2	1.8	1.7	1.9	0.7
Beverages and tobacco	7.9	6.2	5.4	5.9	5.1	3.6
Crude materials except fuels	14.5	13.2	11.6	11.3	9.7	6.3
Mineral fuels and related products	10.5	10.7	11.9	15.4	23.5	17.3
Animal and vegetable oils	3.9	6.3	4.5	3.5	3.7	4.6
Chemicals and related products	0.8	2.0	2.4	1.9	2.6	2.6
Manufactured goods classified by material	4.5	5.0	4.7	4.6	5.5	4.4
Machinery and transport equipment	-0.7	-1.5	-2.1	-2.3	-2.1	-2.6
Miscellaneous manufactured articles	-0.4	-0.1	-0.4	-0.6	-0.4	-0.8

CHART III.37.

The impacts of the fast-rising world prices of energy-producing materials on import prices were strongly corrected by the koruna-dollar exchange rate

(annual percentage changes)



28 Annual oil price inflation rose from 59.3 % in September to 70.3 % in October. In the following two months it slowed and in December it stood at 35.8%. Annual growth in natural gas prices peaked in November at 27.2% (compared to 9.1% in September), then moderated to 26.2% in December.

CHART III.38.

The rise in industrial producer price inflation in October was due mainly to a surge in prices in the mining industry

(annual percentage changes)

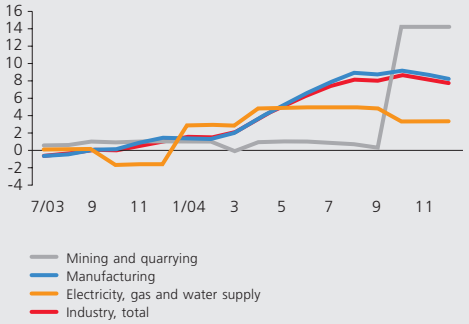


CHART III.39.

But oil- and metal-processing industries contributed most to the annual rise in industrial producer prices

(annual percentage changes; contributions in percentage points)

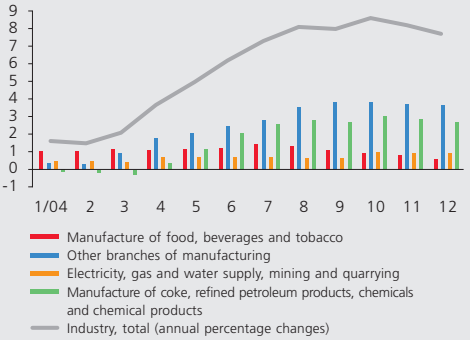
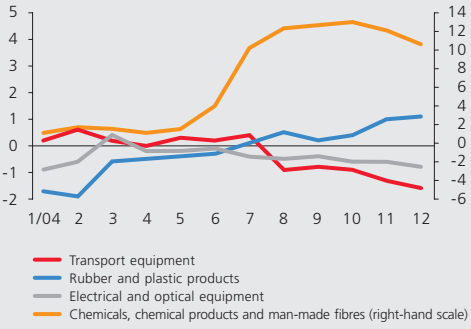


CHART III.40.

The fast rise in industrial producer prices was not across the board in nature

(annual percentage changes; selected branches of industry)



III.7.2. Producer prices

Industrial producer prices

As expected, the rapid growth in industrial producer prices continued into 2004 Q4. This trend peaked in October, when annual industrial producer price inflation reached an eleven-year high (of 8.6%). Although it moderated in the following two months, it remained quite high (7.7% in December). The continuing high inflation in this sector was due to external and internal factors, most notably the continuing surge in prices of imported raw materials and the semi-manufactures made from them (particularly those made from metals) and a sharp rise in coal prices.

The fairly high industrial producer price inflation in 2004 Q4 was again due primarily to prices in branches engaged directly in processing imported mineral fuels, raw materials and the semi-manufactures made from them. After recording stronger annual growth in October (55.1%), producer price inflation in the manufacture of coke and refined petroleum products fell to around 46% in the remaining months of 2004. This was due not only to slower growth in world oil prices, but also to the greater moderating effect of the year-on-year appreciation of the koruna-dollar exchange rate in the last two months of 2004. At the same time, producer prices in the chemical industry were by then showing the effects of the rising prices of oil-product inputs (10.6% year on year in December). Very rapid annual growth also continued in metal-processing industries (around 29% for Q4 as a whole).

Compared to the previous quarter, producer prices in the mining of energy-producing materials contributed more strongly to overall annual industrial producer price inflation in Q4. Here, coal prices recorded quite a strong year-on-year rise before the start of the winter season (from 0.4% in September to 18.8% in December). The main probable causes of this major change were demand-side factors and greater monopolisation of the coal market.

The downward inflation trend in the food industry continued in 2004 Q4 (to 2.6% in December). This was a response to the marked weakening of domestic input price inflation in the previous quarter and the moderation of food import price inflation. In most other branches, producer prices either grew even more slowly than in the food industry or declined year on year, as, for example, in branches manufacturing products with a high degree of processing[29].

Although industrial producer price inflation was very high in 2004 H2, the growth was not across the board in nature. Faster growth was concentrated in just a few branches with a relatively high share of input raw materials in the price of the final product which are engaged in primary processing of imported raw materials. The pass-through of the external cost shocks into producer prices in related branches was more pronounced in only one case, and several other branches experienced only modest price growth. These shocks have yet to feed through

29 Prices declined in the manufacture of electrical and optical equipment and machinery and equipment, probably due to the falling import prices of these products and to excess supply.

to branches with a higher share of sophisticated products. The causes of the so far insignificant pass-through of the rising prices of external inputs into producer prices are specified in detail in section II.1. *Past inflation developments* and section III.5.4. *Financial performance of non-financial organisations and corporations.*

Agricultural producer prices

Annual agricultural producer price inflation stayed relatively low in 2004 Q4 (despite some fluctuations). After moderating relatively quickly from 20% to 1% at the end of Q3, it remained quite low in Q4 (2.4% in December). However, the structural trends were very mixed.

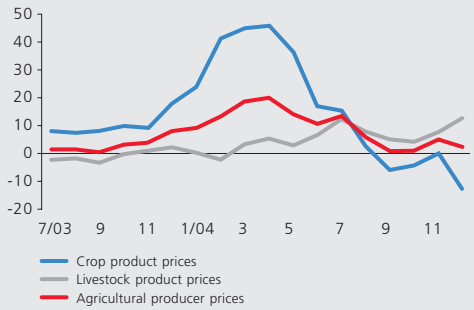
The annual decline in crop prices was largely due to the extraordinarily favourable harvest in 2004 (particularly for cereals, which are a high-weight item), which changed the supply-demand relationship in the agricultural commodity market. A greater moderation of the decline in prices of crop products in November was linked with a relatively large rise in prices of some lower-weight commodities in the overall agricultural producer price index[30]. One of the likely reasons was lower supply on the domestic market due to opportunities to export at better prices after EU accession. A sharp deepening of the decline in crop product prices in December was linked primarily with prices of other crop commodities, some of which fell considerably year on year[31].

Conversely, prices of the higher-weight livestock products continued to record year-on-year growth. This growth picked up further in Q4, reaching 12.7% in December. In this case, too, the already quite high inflation was partly due to opportunities to export to EU countries at better prices (cattle, pigs, milk). Growth in prices abroad — due to excess supply — thus indirectly generated growth in domestic prices, doing so to a larger extent than in previous years.

CHART III.41.

Underlying the modest overall rise in agricultural producer prices were contrary movements in crop and livestock product prices

(annual percentage changes)



Other producer prices

Construction work prices showed no major changes in 2004 Q4 compared to Q3. In a climate of persisting high demand for construction work, inflation in this segment continued to fluctuate just above 4% (4.3% in December). Faster growth in prices of materials and products consumed in the construction industry (up by 8.3% in December) at the same time indicated the effects of the fast-rising prices of metals on world markets (steel structures etc.). Another probable factor underlying the higher construction work price inflation was the buoyant growth in prices of fuels and other oil products, reflecting the surge in oil prices on world markets.

Growth in prices of market services was lower than that in the construction industry, but picked up somewhat in Q4 (to 2.8% in December). Within market services, the fastest growth was recorded in the categories of sewage collection charges, financial intermediation, business activities, real estate activities and

CHART III.42.

Market services price inflation rose slightly at the end of 2004

(annual percentage changes)

30 According to the November figures, hop and sugar-beet prices were up by 15.6% and 64.3% respectively in year-on-year comparison.

31 In December, annual price decreases were recorded for potatoes (down by 59.3%), vegetables (39.6%), fruit (20.7%) and cereals (18.2%).

renting. Prices in the other components of this index rose only modestly. Overall, market services price inflation remained subdued in 2004 Q4 and did not pose significant risks to consumer price inflation.

IV. THE MACROECONOMIC FORECAST AND ITS ASSUMPTIONS

IV.1. EXTERNAL ASSUMPTIONS OF THE FORECAST

Assumptions made about the external environment are one of the key conditions for the construction of the forecast. For this purpose, the CNB has as usual drawn 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 can be assessed as less favourable to growth compared to the October forecast.

The CNB's forecasting system uses data on the German economy to proxy for foreign developments. Although the expectations regarding the growth of the German economy in 2004 — at 1.7% — were fulfilled, the forecast for GDP growth in 2005 has been downscaled from 1.6% to 1.3%. However, the expectations regarding consumer price inflation remain unchanged at 1.4%. The forecasted industrial producer price inflation is also stable at a relatively high level of around 1.5%. In 2006, GDP growth in Germany is expected to reach 1.6% amid inflation of around 1.2%.

Despite some downward adjustment in December 2004, average oil prices were roughly 7% higher in 2004 Q4 than forecasted in October. Owing to the slower unwinding of the oil shock, the Consensus Forecasts have been revised again. The current forecast therefore assumes a Ural crude oil price of almost USD 38 a barrel in 2005 Q1, then a gradual decline to USD 35 a barrel over the remainder of the year. Oil prices are expected to remain stable at this level in 2006. The impacts of the higher oil prices will be dampened by the revision of the outlook for the euro-dollar exchange rate in the Consensus Forecasts.

TABLE IV.1.

The price of Ural crude oil is expected to fall

	I/05	II/05	III/05	IV/05	I/06	II/06	III/06	IV/06
Ural crude oil prices (USD/barrel)	38.0	36.9	35.2	34.5	34.4	34.5	34.5	34.5
Natural gas prices (by import structure, USD/1,000 m³)	161.7	169.1	172.3	172.9	172.7	172.6	172.5	172.5
GDP in Germany (annual, in per cent)	1.3	1.3	1.6	1.0	1.2	1.4	1.5	1.6
Producer price inflation in Germany (annual, in per cent)	2.6	1.8	1.2	0.8	1.4	1.6	1.7	1.7
Consumer price inflation in Germany (annual, in per cent)	1.8	1.3	1.3	1.2	1.3	1.5	1.6	1.6
Nominal USD/EUR exchange rate	1.334	1.331	1.329	1.325	1.318	1.309	1.303	1.300
1Y EURIBOR	2.3	2.3	2.3	2.4	2.5	2.6	2.7	2.7

IV.2. INTERNAL ASSUMPTIONS OF THE FORECAST

In addition to assumptions regarding the external environment, assumptions about the domestic economy are an important input to the forecast. These include the estimated impact of fiscal policy on the economy, which is derived from data on the evolution of the public budget deficit, excluding net lending and subsidies to transformation institutions. The public budget results in 2004 suggest a lower contribution of fiscal policy to economic growth during that year, which also to a great extent changes the estimate for the future evolution of the public budgets. By comparison with the October forecast, the estimate of the public budget deficit has been reduced from 3.5% to 3.2% of GDP in 2005, and the outlook for 2006 is for a further reduction to a level approaching 3%. The expected public budget deficits imply a neutral fiscal policy in 2005 and 2006. The estimated evolution of the public finances is, however, connected with a number of significant uncertainties, which are discussed in more detail in the box *Uncertainty regarding the evolution of public finances in 2005 and 2006*.

Box
Uncertainty regarding the evolution of public finances in 2005 and 2006

The preliminary public budget results for 2004 increase the uncertainty regarding future fiscal developments and their macroeconomic effects in 2005 and 2006. This is mostly due to the state budget deficit, which was roughly CZK 22 billion lower than originally planned. A comparison of the approved state budget and

the preliminary results shows not only that revenues were underestimated, as in 2003, but also that expenditure was very much overestimated. The adjusted deficit according to the approved law was CZK 115.7 billion, whereas the Ministry of Finance reported a deficit of CZK 93.5 billion as of the end of 2004. More than two-thirds of this result can be attributed to higher revenues (especially from taxes) and less than one-third to lower expenditure.

Much more uncertainty is introduced into the considerations of the evolution of the public budgets by the fact that under the current methodology expenditure includes transfers of undrawn funds for reserve funds for future use, which exceeded CZK 29 billion for all the budget chapters combined. From the economic point of view, the actual deficit (not only the accounting deficit) of the state budget was much lower still (taking into account expenditure from reserve funds of roughly CZK 5 billion), at approximately CZK 70 billion. The change in the budgetary rules in mid-2004, which for the first time allowed the carry-over of all undrawn funds into 2005, thus revealed reserves on the expenditure side of the state budget. Currently available data on the results of state funds, local budgets and the National Fund[32] also indicate that these segments, contrary to expectations, could contribute to a reduction in the total government sector deficit in 2004.

Given the underestimation of revenues and overestimation of expenditure, the predicted evolution of public finances and the estimated effect of public finances on the economy in 2005 and 2006 are associated with a high degree of uncertainty. It is not clear whether similar reserves will be created in the state budget in these years, and, if so, and how high they will be, and there is also a risk that the state authorities will change their behaviour and fail to create new reserves, or even "dissolve" the funds carried over from the 2004 budget by increasing expenditure.

Assumptions regarding the equilibrium values of key macroeconomic variables are also important 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 setting 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 (i.e. non-accelerating inflation) output.

Among other things, analyses of past and present developments in economic activity, inflation, the exchange rate and interest rates are used to determine the starting conditions of the forecast and the equilibrium variables. The linkages between these variables, which represent the CNB's fundamental view of the transmission mechanism, are also used.

No information leading to a reassessment of the evolution of equilibrium real interest rates and the equilibrium real exchange rate came to light during 2004. Thus the one-year real equilibrium interest rate has been set at 1.5% since April

32 The National Fund is a pool of funds entrusted to the Czech Republic by the European Communities for the implementation of programmes or projects co-financed from the EU budget, with the exception of support for rural development. The National Fund is an off-budget fund, but it is a part of the public budgets balance.

2004. As in April, July and October, the equilibrium real exchange rate is expected to strengthen at a rate of slightly less than 3%. It will, however, fall gradually to 2% in 2007 H1. The forecast assumes a growth rate of potential output (i.e. the non-accelerating inflation rate of output) of between 3% and 3.5%.

The information on economic activity published in the first three quarters of 2004 confirmed the CNB's previous forecasts of an upturn in economic activity. However, the prediction of GDP growth for 2004 as a whole was not completely fulfilled. This was partly due to the revision of GDP growth in 2003 and 2004 by the CZSO, but fiscal policy, which was more restrictive than expected in the October forecast, also played a role. As expected, economic growth is being driven mainly by investment and exports, while household consumption growth is gradually slowing. The gradual slowdown in household consumption growth during 2004 was due to a fall in real household disposable income growth amid a broadly neutral interest rate component of the monetary conditions in 2003 H2. On the other hand, the buoyant investment growth was fostered by an improved outlook for exports related to the easy effect of the real exchange rate in the previous period.

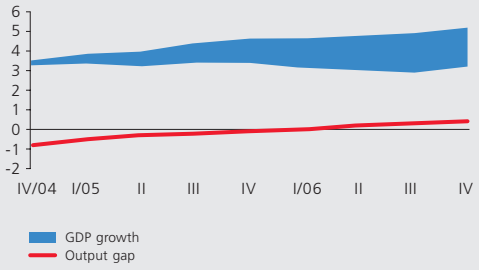
The observed evolution of inflation, especially adjusted inflation excluding fuels, differed from the assumptions of the October forecast only slightly, but on the whole towards lower inflation. The position of the economy in the business cycle thus continued to act in a disinflationary direction. The stable inflation combined with the slower-than-expected GDP growth led to a downward revision of the rate of closure of output gap at the end of 2004. The analyses generate an estimated output gap for 2004 Q4 of around -0.8 % of GDP.

Based on the interrelationship between the monetary conditions and the output gap, as expressed by the view of the transmission mechanism, the initial setting of the monetary conditions in 2004 Q4 is on average assessed as easy in both the interest rate component and the exchange rate component. While the easing of the exchange rate component has been gradually downscaled since the beginning of the year owing to the nominal appreciation of the exchange rate, the easing of the interest rate component has remained broadly stable since mid-2004.

CHART IV.1.

The output gap will close at the beginning of 2006

(annual percentage growth)



IV.3. THE MESSAGE OF THE FORECAST

Although the current forecast still expects increased economic activity in 2005 and 2006, the forecast for growth in economic activity has been revised downwards compared to the October forecast. This is due to the slower closing of the output gap assumed at the end of 2004 and the tighter monetary conditions resulting from the appreciation of both the nominal and real exchange rate. However, the lower expected economic activity compared to the October forecast should also be attributed to the downward revision of the recovery abroad. Expected real GDP growth will thus be around 4% in 2005 and 2006. Assuming potential output growth of between 3% and 3.5%, the output gap can be expected to close at the beginning of 2006. As for the labour market, the gradual closing of the output gap will result in a moderate increase in employment and a fall in the unemployment rate below 10%.

After its slight decline in 2004, household consumption growth is expected to rise somewhat to around 3% year on year in 2005 and increase to 3.5% in 2006. Owing to the broadly neutral interest rate component of the monetary conditions

TABLE IV.2.

Real disposable income growth will slow in 2006

	2005	2006
Real disposable income of households (annual growth in per cent)	3.5	2.8
Unemployment rate (in per cent)	10.0	9.7
Labour productivity (annual growth in per cent)	3.4	3.7
Current account deficit (ratio to GDP in per cent)	-4.6	-4.5
M2 (annual growth in per cent)	6.0	6.8

TABLE IV.3.

Economic growth will be driven by exports and investment

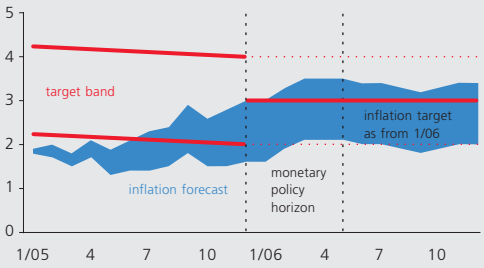
(annual percentage changes)

	2005	2006
Gross domestic product	3.8	4.0
Total domestic demand	3.3	5.2
of which:		
Household consumption	3.0	3.5
Government consumption	-1.2	1.6
Gross fixed capital formation	9.1	7.6
Imports of goods and services	11.1	12.6
Exports of goods and services	11.2	12.1
Net exports of goods and services in CZK bn	-281.0	-326.2

CHART IV.2.

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

(annual consumer price inflation; percentages)



in 2003 H2, the forecasted household consumption growth in 2005 is consistent with gross real disposable income growth of roughly 3.5%. The expected faster household consumption growth in 2006 will be driven by a reduction in the savings rate, as real disposable income growth will slow to 2.8%. The expected reduction in the savings rate in 2006 ensues from the easy interest rate component of the monetary conditions since 2004 H2.

Despite the appreciation of the koruna and the expected slowdown in economic growth abroad, growth will continue to be driven mainly by real exports and, consequently, by investment. The forecasts for investment and real exports, however, have been revised downwards compared to October. Growth in real exports will reach approximately 11% in 2005 and 12% in 2006. Given the relatively high import intensity of both investment and exports, however, the still relatively fast growth rates of exports and investment will not be accompanied by a reduction in the net export deficit at constant prices. From the point of view of current prices, on the other hand, the foreign trade trend will generate a gradual improvement of the trade deficit. Running counter to this, however, will be a concurrent deterioration in the income balance. The forecast therefore expects the current account deficit to remain roughly at CZK 140 billion in 2005 and CZK 150 billion in 2006.

The baseline scenario of the forecast assumes only gradual appreciation of the nominal exchange rate. This assumption of smooth movement of the exchange rate contrasts with the step appreciation at the turn of the year, which was not based on the fundamental factors taken into account in the prediction. Given the broadly neutral effect of the interest rate differential, the predicted moderate appreciation of the exchange rate is caused by a gradual decline in the risk premium resulting from the convergence of the Czech economy towards the advanced economies. The sharp appreciation at the end of 2004 will be only partly offset by higher growth in energy import prices. The forecast therefore expects import price inflation to drop gradually below zero in the course of 2005.

The expected inflation path is determined by the combined demand pressures resulting from real economic activity, imported inflation and other exogenous factors. The revision of the estimate of future demand 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[33], the centre of the inflation forecast is slightly below the CNB's point target.

Compared to the October forecast, the forecast for adjusted inflation excluding fuels has shifted downwards. The forecast is for headline inflation of around 2.2% at the end of 2005, compared to the 2.8% forecasted in October. The forecast then expects demand-pull inflationary pressures to arise in 2006. These, however, will emerge later and will be weaker than forecasted in October. Therefore, the forecast also revises the outlook for inflation at the end of 2006 to 2.7%, from the 3.1% forecasted in October. The impact of changes in the estimated effect of regulated prices and tax changes on the forecast is assessed as negligible.

33 The January Inflation Report introduces a new expression for the horizon highlighted in the inflation forecast chart, i.e. the horizon which monetary policy makers look at when making their decisions and which takes into account the monetary policy transmission lag. The formerly used term "horizon of most effective transmission" has been replaced by "monetary policy horizon", which better reflects its role in the CNB's forecasting system.

The expected rise in excise duties on cigarettes had already been incorporated into the previous forecasts. The current forecast again merely shifts the first step in this process to 1 June 2005. The second step is still planned for 1 January 2006. The assumption that these changes will have fairly limited secondary effects remains unchanged.

Consistent with the January forecast and its assumptions is a moderate fall in interest rates in 2005 H1. Gradual interest rate growth has been put back to 2006 H1.

When the current forecast was being prepared, an alternative scenario of different fiscal policy effects in 2005 and 2006 was discussed, reflecting the uncertainty arising from the transfer of undrawn funds from the budget to reserve funds (see the box *Uncertainty regarding the evolution of public finances in 2005 and 2006*). Two versions of the alternative scenario were drawn up, the first one assuming that reserves will continue to be created in the years ahead, and the second one examining the possibility of a gradual dissolution of the existing reserves. The former would result in a negligibly negative contribution of fiscal policy to economic growth in 2005 and 2006. The resulting deferral of the output gap closure to 2006 Q2 would lead to somewhat lower demand pressures and the need for slightly easier monetary policy. Inflation would remain almost unchanged at the monetary policy horizon by comparison with the baseline scenario.

The latter scenario would result in a markedly positive contribution of fiscal policy to economic growth in 2005 and 2006. Consistent with that contribution are closure of the output gap already in 2005 H1 and its growth towards 0.5% at the end of 2005, negligibly higher inflation at the monetary policy horizon and the need for a slightly tighter setting of monetary policy compared to the baseline scenario.

In the inputs for the CNB Bank Board meetings, some forecast risks are assessed in the form of technical simulations describing the sensitivity of the forecast to a unit change in the given variable compared to the baseline scenario. In connection with the aforementioned considerable exchange rate fluctuations at the turn of 2005, attention should be paid to the simulation describing the sensitivity of the forecast to the possibility that the exchange rate of the domestic currency against the euro would deviate from the baseline scenario trajectory towards appreciation by one koruna for one quarter and then gradually return to its forecasted path. This simulation confirmed the high sensitivity of the Czech economy to exchange rate developments. In this simulation, the closure of the output gap is, by comparison with the baseline scenario, deferred by approximately half a year and the interest rates consistent with this simulation fall markedly faster during 2005 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 fall to 2% at the beginning of 2005 because of the lower contribution of regulated prices and tax changes compared to 2004. The inflationary pressures are furthermore being contained by appreciation of the koruna against the euro and the dollar. Food prices, on the other hand, are having an upward effect on inflation. This is due to a rise in prices of livestock products resulting from the EU's greater openness to Czech farmers. Prices of commodities, particularly oil, remain an inflationary risk. The analysts

TABLE IV.4.

Growth of adjusted inflation excluding fuels will be the main driving force behind rising inflation

(annual percentage growth)

	I/05	II/05	III/05	IV/05	I/06	II/06	III/06	IV/06
Annual consumer price inflation	1.8	1.8	2.0	2.2	2.5	2.8	2.6	2.7
Breakdown into contributions:								
regulated prices	2.4	4.2	5.6	4.0	3.2	2.3	2.2	2.1
indirect taxes (contributions in p. p.)	0.4	0.2	0.3	0.4	0.6	0.8	0.5	0.4
food prices, excluding effects of indirect taxes	0.8	0.3	-0.2	0.7	0.9	1.2	1.5	1.6
fuel prices, excluding effects of indirect taxes	3.3	-4.6	-6.1	-6.6	-3.3	-2.3	-1.8	-0.9
adjusted inflation excluding fuels, excluding effects of indirect taxes	1.3	1.5	1.6	2.0	2.2	2.4	2.6	2.8

TABLE IV.5.

The inflation expectations of economic agents were consistent with the CNB's target

(percentages)

	12/03	9/04	10/04	11/04	12/04
Consumer price index					
1Y horizon:					
Financial market	3.3	3.0	2.8	2.8	2.8
Corporations	2.9	3.1	—	—	3.2
Households	4.2	1.7	—	—	1.5
3Y horizon:					
Financial market	2.8	2.9	2.9	2.7	2.8
Corporations	2.8	2.7	—	—	2.7
Households	4.6	2.0	—	—	1.8
1Y PRIBOR					
1Y horizon:					
Financial market	3.1	3.8	3.7	3.5	3.4

expect demand-pull inflationary pressures to emerge in the Czech economy in 2005 H2, owing to faster wage growth and fairly robust growth of the domestic economy. The inflation expectations of corporations are almost unchanged. A further fall 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 are consistent with the CNB's target of 3%, while the expectations of households are currently lower.

Expected interest rates decreased in the period under review. The settings of key interest rates consistent with the CNB's forecast in the immediate future were broadly in line with the view of financial market participants. At the longer horizon, expected interest rates were above the CNB's forecast.

Box
Inflation expectations in the CNB's modelling system

Inflation expectations have a special position in the inflation targeting regime. The deviation of expectations from the inflation target determines the credibility of the target or even the credibility of monetary policy itself. Inflation expectations also play an important role in determining whether monetary policy is tight or easy. This is because real interest rates, defined as the difference between nominal interest rates and future inflation expectations, are the main component of the monetary conditions.

In the CNB's modelling system, inflation expectations are estimated. The inflation expectations obtained from statistical surveys (see the box in the July 2003 Inflation Report) and regularly described in this section are not inputted directly into the modelling system, but are used to check the consistency of the model expectations with the statistically measured expectations. The reason for this is that statistical measures of inflation expectations are associated with many imperfections, meaning that the expectations measured may not correspond to actual ones and are highly volatile.

The modelling system assumes that inflation expectations are formed predominantly (90%) by the latest inflation developments and to a lesser extent (10%) by the forecast for future inflation.

ANNEX

ASSESSMENT OF THE FULFILMENT OF THE MAASTRICHT CONVERGENCE CRITERIA AND THE DEGREE OF ALIGNMENT OF THE CZECH ECONOMY WITH THE EURO AREA

(Document prepared by the Ministry of Finance of the Czech Republic, the Ministry of Industry and Trade of the Czech Republic and the Czech National Bank, and approved by the Government of the Czech Republic on 12 January 2005)

I. SUMMARY AND RECOMMENDATIONS REGARDING THE CZECH REPUBLIC'S PREPAREDNESS FOR JOINING THE ERM II

This part outlines the main conclusions of parts II and III of this document.

Part II provides an assessment of the current and expected fulfilment of the Maastricht convergence criteria. In compliance with EU legislation, EU Member States have to achieve a high degree of convergence as a precondition for joining the euro area. This is measured by the sustainability of fulfilment of four convergence criteria: sustainability of price stability observable from inflation developments; the long-term sustainability of the government budgetary position as measured by the government deficit and government debt; the sustainability of exchange rate stability; and the durability of convergence as reflected in long-term interest rate levels. The Czech Republic as an EU Member State is obliged to take steps to be prepared for joining the euro area as soon as possible. However, potential non-fulfilment of the convergence criteria has no consequences for the Czech Republic at present. The only exception is the criterion on the sustainability of public finances, or the level of the public finance deficit, whose fulfilment poses the greatest problem to the Czech Republic at present. The observance of budgetary discipline is subject to multilateral surveillance of public finance developments, and failure to observe it led to the commencement of the excessive deficit procedure against the Czech Republic. As a result, the Czech Republic has undertaken to reduce the government deficit below 3% of GDP by 2008.

The criterion on price stability is at present being fulfilled comfortably. However, this is partly due to the extraordinarily low inflation last year. As regards future fulfilment of this criterion, there exist a number of uncertainties: whether and which countries will be excluded from the calculation of the reference value for inflation, how far this value will be from the definition of price stability as perceived by the ECB, etc. The CNB's inflation target for the national consumer price index for the period starting 2006 has been set at 3%. It can be expected that this level will correspond to fulfilment of this criterion near its upper boundary provided that price developments in the EU Member States do not deviate too far downwards from the ECB's definition of price stability (inflation "below, but close to 2%"). However, the possibility of short-term non-fulfilment of this criterion cannot be ruled out in the case of unforeseen events with a strong inflationary effect.

The Czech Republic is not compliant with the criterion on sustainability of public finances. The deficit has been above the reference value of 3% of GDP for some time. Given the government's current commitment, fulfilment of the deficit criterion can be expected in 2008, which constitutes a major limitation with respect to the timing of euro adoption. The government debt is still relatively low (despite the present upward trend) compared to the reference value of 60% of

GDP. Provided that the government's fiscal strategy is implemented, fulfilment of this criterion at the assumed time of the examination should not be in any danger.

Formal assessment of the exchange rate criterion will only be possible after joining ERM II. Moreover, the interpretation of this criterion should not be mechanical, but should also reflect the economic arguments regarding the reasons for potential exchange rate fluctuations. At present it can thus only be stated that if exchange rate stability is evaluated based on a fluctuation band much narrower than the 15% permitted in ERM II, the koruna's exchange rate has been quite volatile, although it has calmed down in the last two years. The centre of the exchange rate fluctuation band, which will be set for the Czech koruna upon ERM II accession, will be another key parameter.

The Czech Republic is currently compliant with the long-term interest rate criterion without any problems. The outlook for several years ahead does not indicate any problems in this area, either. Some risk is associated with the implementation of the reform of public finances. If the reform is not realised, this may result in a downgrading of the Czech Republic's international rating, a higher risk premium on government bonds and consequently an increase in long-term interest rates (above the reference value in the extreme case).

Part III provides an overview of the results of underlying analyses conducted to assess the Czech economy's degree of alignment with the euro area. Unlike the Maastricht criteria with their clearly defined limits for joining the euro area, these analyses cannot arrive at a definitive conclusion on whether the degree of economic alignment is sufficient for adopting the euro. These analyses are aimed rather at assessing the evolution of the alignment indicators over time and in comparison with the existing and aspiring euro area member countries. Such assessments may be used to facilitate the decision on euro adoption, but in the end this decision is a political one. At the same time, these assessments make it possible to identify bottlenecks requiring further reform efforts on the part of the government and the CNB.

The analyses can be divided into two groups depending on whether they examine the Czech economy's similarity and alignment with the euro area economy (Part III.1.) or the ability of the Czech economy to cope with the fact that it is not fully aligned with the euro area (Part III.2.). A low degree of alignment would mean that the Czech economy would be hit by the effects of unforeseen events more strongly than most euro area economies. The response of the single ECB policy would then be insufficient and the Czech economy would have to cope with them using its own adjustment mechanisms. It is therefore essential to assess the extent to which the Czech economy is capable of such adjustment.

The first group includes, among other things, analyses of GDP growth alignment. The calculations used in these analyses provide an ambiguous picture. Slowing growth in Europe was, together with the exchange rate appreciation, one of the main factors of a moderation of Czech economic growth in 2001—2002. By contrast, the present modest recovery in the EU is one of the stimuli for a pick-up in Czech economic growth. This might indicate an increasing degree of cyclical alignment with the EU. However, more subtle statistical calculations reveal that by international comparison the alignment is average or rather unfavourable. This could pose a risk if the euro is introduced too soon. One of the possible reasons for this situation is the substantial impact of exchange rate fluctuations on economic growth in the Czech Republic in recent years. Euro adoption will

eliminate this exchange rate effect, which may increase the alignment of the business cycle with the euro area.

The Czech economy's high (and ever increasing) openness and its strong orientation towards trade with the EU are arguments for early adoption of the euro. The structural characteristics of foreign trade are also favourable for adopting the single currency, since they decrease the probability of the Czech Republic being hit by shocks not affecting the EU as a whole.

The financial sector has created satisfactory conditions to ensure that this sector is not a source of problems for the domestic economy after euro adoption and to allow for transmission of monetary policy measures into the economy in a manner comparable with the rest of the euro area. This applies despite the fact that the Czech financial sector is smaller than those in the euro area countries.

The second group includes analyses of the Czech economy's ability to react flexibly when, as a result of insufficient alignment with the euro area, domestic macroeconomic developments deviate from those in the euro area and hence the ECB's single monetary policy does not respond to them. Fiscal policy should be a significant instrument of the economy's flexibility. The more the government can reduce the structural component of the public finance deficit towards balance, the more room will be left for the free functioning of built-in automatic stabilisers without the final deficit contravening the Stability and Growth Pact rules. The present project of fiscal consolidation in the Czech Republic is thus a necessary, but not sufficient step to ensure the stabilisation function of public budgets within the European fiscal regulations.

The Czech economy's resilience to shocks will also strongly depend on the flexibility of the Czech labour market. The ability of the Czech labour market to absorb shocks is quite satisfactory by European comparison. Nonetheless, there are areas where the labour market is much less flexible and the monitored indicators suggest a risk of further deterioration. These indicators include a rising proportion of long-term unemployment and growing regional differences. The institutional rules on the labour market handicap above all people with low skills. The main risk factors are relatively high labour taxation, the interaction of taxes and social benefits and a rising minimum wage. Greater labour market flexibility is one of the EU's priorities and the Czech Republic should follow this trend.

The third important element of the Czech economy's ability to resist external shocks is the financial sector. According to the analyses conducted, this sector is relatively well prepared for this role. As of the end of 2003, the Czech banking sector recorded satisfactory loan quality. The coverage of non-performing loans by provisions in the Czech Republic is at a level comparable with other European countries. The sufficient coverage of potential risks is also evidenced by a high capital adequacy ratio. The sector's resilience is moreover enhanced by high profitability.

Based on the aforementioned analyses and in line with the earlier approved euro adoption strategy, the Ministry of Finance, the Ministry of Industry and Trade and the Czech National Bank recommend that the Czech Government does not to attempt to enter the ERM II during 2005. The reason is that the conditions have yet to be created for the Czech Republic to meet the requirements for joining the euro area two years after entering the ERM II and to be able to benefit from adopting the euro. Any future change regarding this recommendation depends

primarily on progress with the public finance reform and other structural reforms directed at increasing the flexibility of the Czech economy.

II. ASSESSMENT OF THE CURRENT AND EXPECTED FULFILMENT OF THE MAASTRICHT CONVERGENCE CRITERIA

The convergence criteria (price stability, the sustainability of the government budgetary position as measured by the government deficit and government debt, exchange rate stability, and the durability of convergence based on long-term interest rates)[34] are defined in the EC Treaty (hereinafter referred to as the "Treaty") and specified in the Protocol on the Convergence Criteria and the Protocol on the Excessive Deficit Procedure annexed to the Treaty. In compliance with the above regulations, prior to applying for monetary union accession, EU Member States with a derogation have to fulfil the convergence criteria in a sustainable manner, not only on points.

The Treaty obliges two institutions — the European Commission and the European Central Bank — to assess at least every two years the fulfilment of the convergence criteria in Member States with a derogation. In practice, however, this assessment is done every year[35] and its outputs are two separate documents: the EC Convergence Report and the ECB Convergence Report[36].

The conclusions of both the European Commission's 2004 Convergence Report and the European Central Bank's 2004 Convergence Report point out that the Czech Republic is compliant with only two of the four convergence criteria — the criterion on price stability and the criterion on long-term interest rates. This document arrives at the same conclusion. The table below gives a general assessment of all EU Member States with a derogation.

Table 1: Fulfilment of the convergence criteria in 2004

(comparison of EU Member States with a derogation, according to EC Convergence Report)

	Price stability	Government budgetary pos. (deficit, debt)	Exchange rates	Long-term interest rates
Czech Republic *	yes	no	no	yes
Estonia**	yes	yes	no	—
Cyprus *	yes	no	no	yes
Latvia	no	yes	no	yes
Lithuania **	yes	yes	no	yes
Hungary *	no	no	no	no
Malta *	no	no	no	yes
Poland *	no	no	no	no
Slovenia **	no	yes	no	yes
Slovakia *	no	no	no	yes
Sweden	yes	yes	no	yes

Source: European Commission, October 2004

* Excessive deficit procedure opened against country by Council decision of 5 July 2004
** Entered ERM II on 28 June 2004

34 See Article 121 of the Treaty.
35 See Article 122(2) of the Treaty. At present, the "old" Member States include only Sweden, since Denmark and the United Kingdom negotiated opt-out clauses before they signed the Maastricht Treaty.
36 The latest Convergence Reports of both institutions date from October 2004 and evaluate the state of convergence in all the new Member States and Sweden.

ASSESSMENT OF FULFILMENT OF THE MAASTRICHT CRITERIA IN THE CZECH REPUBLIC

II.1. CRITERION ON PRICE STABILITY

The criterion on price stability requires that a Member State has a price performance that is sustainable and an average rate of inflation, observed over a period of one year (the preceding 12 months) before the examination, that does not exceed by more than 1.5 percentage points that of, at most, the three best performing Member States in terms of price stability. This criterion is monitored on the basis of the Harmonised Index of Consumer Prices (HICP)[37].

Table 2: Harmonised Index of Consumer Prices

(average for last 12 months vs. average for previous 12 months, growth in %)

	2001	2002	2003	8/04	2004	2005	2006	2007
Av. for 3 countries with lowest inflation	1.6	1.1	1.2	0.9	0.9	1.0	1.2	1.3
Reference value (1st line + 1.5 p.p.)	3.1	2.6	2.7	2.4	2.4	2.5	2.7	2.8
Czech Republic	4.5	1.4	-0.1	1.8	2.7	3.2	2.6	2.2

Source: Eurostat, European Commission, convergence programmes and stability programmes of Member States, Convergence Programme of the Czech Republic (November 2004)

Note: The outlook for inflation in the European Union for 2004—2005 is taken from the European Commission's spring economic forecast and that for 2006—2007 from the Member States' convergence programmes and stability programmes. The forecast for the Czech Republic is taken from the Czech Republic's Convergence Programme (November 2004). It may therefore differ somewhat from the forecasts of some of the institutions involved in preparing this document (for example the CNB).

When constructing the forecast for the future fulfilment of the inflation criterion we can choose from a variety of interpretations of the words "best performing Member States in terms of price stability". This is confirmed by the fact that the interpretations used in this year's EC and ECB Convergence Reports were slightly different from each other; the issue of interpretation of the criterion will have to be addressed. The forecasts for the reference value provided in Table 2 are based on the simplified assumption that the reference value will be calculated as the average inflation rate in the three states with the lowest positive inflation. However, given that the interpretation of the inflation criterion is not yet fully established, these forecasts should be regarded as only tentative.

The above table shows that, according to the interpretation used, the Czech Republic is compliant with the price stability criterion. However, this partly reflects extraordinarily low inflation the previous year. Except for a temporary pick-up in inflation in 2004—2005, the Czech Republic should, according to the Czech Ministry of Finance's projections, continue to fulfil the inflation criterion. The CNB's inflation target for the national consumer price index for the period starting 2006 has been set at 3%[38]. It can be expected that this level will correspond to fulfilment of this criterion near its upper boundary provided

37 There are some differences between the composition of the consumer basket of the national consumer price index of the Czech Republic and the HICP composition. The HICP weights include revenues from purchases by foreigners in the territory of the Czech Republic, but do not include hypothetical rents, whereas the national consumer price index does not include revenues from purchases by foreigners, but does include hypothetical rents.

38 For details, see the document *The CNB's inflation target from January 2006* of 11 March 2004.

that price developments in the EU and its Member States do not deviate too far downwards from the target value (inflation "below, but close to 2%"). This does not exclude the possibility of short-term non-fulfilment in case of inflation shocks.

II.2. CRITERION ON SUSTAINABILITY OF PUBLIC FINANCES

The EU Treaty obliges the Member States to avoid excessive government deficits; the observance of budgetary discipline is examined based on the government deficit and government debt criteria defined according to the version of the European System of National Accounts in effect when the Maastricht Treaty was signed. Accordingly, the convergence criterion in the area of public finances is defined as sustainability of the government financial position without excessive deficits.

a) Government deficit criterion

The government deficit convergence criterion requires that the ratio of planned or actual government deficit to GDP does not exceed 3%, unless:

— either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively,
— the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value.

The term "government deficit" means net borrowing of the general government, as defined in ESA 95, with minimal deviations.

Table 3a: General government deficit
(ESA 1995 methodology, in % of GDP)

	2001	2002	2003	2004	2005	2006	2007
Reference value	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0
Czech Republic	-5.9	-6.8	-12.6	-5.2	-4.7	-3.8	-3.3

Source: CZSO, Convergence Programme of the Czech Republic (November 2004)

Note: The data for 2001—2003 are those notified by the CZSO; the data for 2004—2007 are estimates of the Ministry of Finance.

Under the present public finance parameters, the Czech Republic is unable to fulfil the general government deficit criterion. The ongoing public finance reform assumes a gradual reduction of the deficit to 3.3% in 2007. Provided that the reform process is successful and the pace of consolidation is maintained, compliance with the convergence criteria can be expected in 2008.

b) Government debt criterion

The government debt convergence criterion stipulates that the ratio of government debt to GDP at market prices should not exceed 60%, unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.

The term "government debt" means total gross debt of the general government according to ESA 95, with some partial methodological adjustments[39].

Table 3b: Government debt
(ESA 1995 methodology, in % of GDP)

	2001	2002	2003	2004	2005	2006	2007
Reference value	60.0	60.0	60.0	60.0	60.0	60.0	60.0
Czech Republic	25.3	28.8	37.8	38.6	38.3	39.2	40.0

Source: CZSO, Convergence Programme of the Czech Republic (November 2004)

Note: The data for 2001—2003 are those notified by the CZSO; the data for 2004—2007 are estimates of the Ministry of Finance.

Given the still low initial level of government debt, the Czech Republic as yet has no problem fulfilling this criterion. The rate of growth in debt visible in recent years should slow thanks to the public finance reform. Moreover, the government debt growth also reflected the inclusion of the majority of the indirect liabilities of the government (particularly government guarantees) identified in 2003. Successful completion of the fiscal consolidation should stabilise the government debt level safely below the reference value.

II.3. EXCHANGE RATE STABILITY CRITERION

The assessment of fulfilment of the exchange rate convergence criterion is based on the relevant provisions of the EU Treaty, which are developed further in the relevant Protocol and the Resolution of the European Council establishing the ERM II exchange rate mechanism with effect from 1 January 1999. The current position of European authorities as regards the exchange rate criterion can be summarised as follows:

a) participation in ERM II for at least two years at the time of the assessment is mandatory;
b) no downward realignment of the central parity is permitted within the two-year examination period;
c) compliance with the two aforementioned requirements is a necessary, but not sufficient condition for fulfilling the criterion on exchange rate stability. Emphasis is laid on movements relatively close to the central parity "without severe tensions". If the exchange rate moves further from the central parity, a distinction must be made between upward and downward deviations, and it is necessary to analyse their duration, the reasons for them, and the interest rate and intervention policy settings in that period.

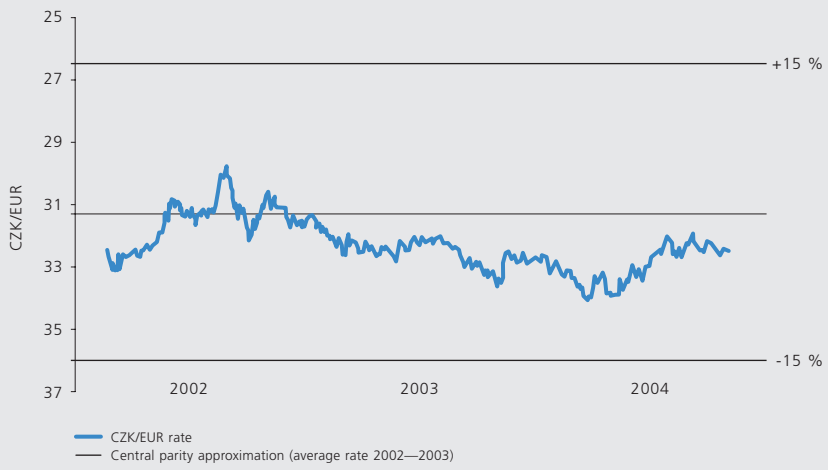
The above description of the exchange rate criterion assessment suggests that it can be formally fulfilled only after the central parity of the CZK/EUR rate is set. In

39 Debt is recorded at nominal value outstanding at the end of the year after consolidation, i.e. except for liabilities corresponding to the financial assets held by other government subsectors. For the calculation of the criterion, government debt includes securities other than ownership interests (e.g. T-bills, government bonds) and loans (e.g. credits, returnable financial aid).

the following chart the central parity is simulated by the average of the daily rates for 2002 and 2003.

The developments in the last few years show that the exchange rate fluctuations are clearly smaller than the hypothetical band of 15%. Nonetheless, the deviations from the average rate were still quite significant. We cannot therefore say for sure whether the present situation would be assessed as compliant with the condition of movement close to the central parity "without severe tensions". The uncertainty is compounded by the fact that the approaches of the EC and ECB to this criterion may differ slightly from each other.

Chart 1: Nominal CZK/EUR rate



Source: CNB

Note: In the chart, upward movement means appreciation and downward movement means depreciation.

Successful participation in ERM II depends in particular on the degree of alignment with the euro area economy, on market flexibility and on the consistency of economic policies. The euro-strategy recommends participation in ERM II only for the minimum required period of two years. This implies that "the Czech Republic should enter the ERM II only after conditions have been established which enable it to introduce the euro at the time of the assessment of the exchange rate criterion and to then benefit from its introduction without experiencing any problems"[40]. For this reason one can expect that when it enters the ERM II the Czech economy will be better prepared for fulfilment of the exchange rate criterion than in the past.

40 *The Czech Republic's Euro-area Accession Strategy.*

Compared to the present exchange rate regime of managed floating, ERM II entry is a new element which might have a substantial effect on the behaviour of the exchange rate. The key problem with switching to the ERM II mechanism is probably the appropriate (sustainable) setting of the central parity.

II.4. CRITERION ON LONG-TERM INTEREST RATES

The criterion on long-term interest rates requires that over a period of one year before the examination, a Member State has had an average nominal long-term interest rate that does not exceed by more than 2 percentage points that of, at most, the three best performing Member States in terms of price stability. Long-term interest rates are calculated on the basis of the yield to maturity of 10-year government bonds on the secondary market.

Table 4: 10-year interest rates on government bonds on the secondary market
(average for the last 12 months, in %)

	2001	2002	2003	8/04	2004	2005	2006	2007
Av. for 3 countries with lowest inflation	4.92	4.85	4.12	4.30	3.8	3.9	4.2	4.2
Reference value (1st line + 2 p.p.)	6.92	6.85	6.12	6.30	5.8	5.9	6.2	6.2
Czech Republic	6.31	4.88	4.12	4.74	4.9	5.3	5.4	5.5

Source: Eurostat, Macroeconomic Forecast of the Czech Ministry of Finance (October 2004)

The Czech Republic is currently compliant with the criterion on long-term interest rates and no problems are expected in this area in the future. The forecast for interest rates on government bonds in the Czech Republic is, however, critically dependent on the successful completion of the public finance consolidation. Any loss of financial market confidence in the outcome of the fiscal reform could very quickly pass through into a rise in the risk premium on long-term interest rates and endanger the fulfilment of this convergence criterion.

III. ASSESSMENT OF THE CZECH ECONOMY'S ALIGNMENT WITH THE EURO AREA

This part provides an overview of the results of several underlying analyses directed at assessing the Czech economy's degree of alignment with the euro area. These analyses are aimed at assessing the evolution of the alignment indicators over time and in comparison with existing and aspiring euro area member countries. Therefore, it is not our goal to formulate a straightforward conclusion on whether the degree of economic alignment is sufficient for the adoption of the single currency.

The underlying analyses assessed the degree of alignment using the theory of optimum currency areas. Part III.1. Cyclical and Structural Alignment indicates the extent of the risk of asymmetric shocks in the Czech economy vis-à-vis the current euro area

41 As neither the EC Forecast nor the stability programmes of the countries that should, according to the inflation forecast, form the basis for calculating the criterion include a forecast of long-term interest rates at the time horizon under review, the projection of this criterion's value in Table 4. is based on the technical assumption that long-term interest rates will move in line with inflation, i.e. real interest rates will not change. This criterion's value in 2004—2007 should therefore be viewed as only tentative.

and vis- à -vis the EU-25. These two reference economies represent the narrower and wider concepts of the future form of the euro area. At present it is not possible to determine unequivocally which concept will be closer to the actual composition of the euro area when the Czech Republic joins it. Part III.2. Adjustment Mechanisms answers the question of to what extent the Czech economy is capable of dampening the impacts of possible "asymmetric shocks", i.e. cases where domestic macroeconomic developments deviate from developments in the rest of the euro area. The situation in the Czech Republic was compared with that in selected euro area member countries (Austria, Portugal and Greece, and also Germany in the case of the foreign trade structure analysis) and in selected non-euro area EU Member States aspiring to adopt the euro in the future (Poland, Slovakia and Hungary)[42].

III.1. CYCLICAL AND STRUCTURAL ALIGNMENT

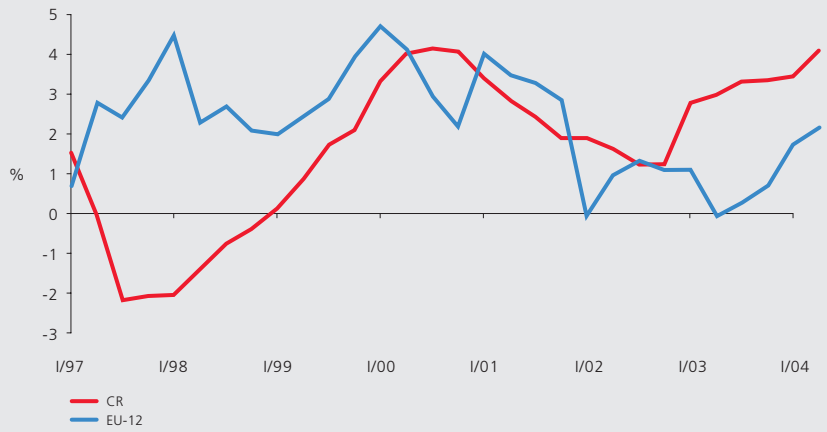
Upon adopting the single currency, the Czech Republic will lose its own monetary policy, thereby losing a whole set of instruments that make it possible to influence the Czech economy independently. This loss will be particularly felt if the Czech economy is not aligned with the euro area economy and deviates frequently from it. The risks arising from the Czech Republic's accession to the euro area will decrease as the degree of alignment increases.

Macroeconomic approach

In 2001 and 2002, the slowdown in European economic growth was, together with the currency's appreciation, one of the main factors underlying the slowing growth of the Czech economy. Conversely, the current modest recovery in the EU is an impulse for faster growth in the Czech Republic. This might indicate a rising degree of cyclical alignment with the EU.

Chart 2: GDP growth in the Czech Republic and the euro area

(year on year)



Source: CZSO, Eurostat

42 All the analyses attempted to make comparisons with all the selected countries, but in some cases that was not possible owing to a lack of relevant statistical data.

On the other hand, data on the alignment of Czech GDP growth with GDP growth in the euro area and the EU-25 have not confirmed this conclusion so far, despite the use of more subtle statistical calculations[43]. The evolution of these indicators from 1995 to 2003 does not show a smooth increase in the alignment of the business cycles in the Czech Republic and the euro area. Analyses indicate that the occurrence of demand shocks has been converging with the euro area, while the differences in supply shocks have been widening. From this point of view, early adoption of the euro might generate significant costs, because the single monetary policy might not suit developments in the Czech Republic. However, some of the current euro area members (e.g. Portugal, Austria and Greece) are in a similar situation.

The question of whether the exchange rate dampens or amplifies fluctuations in the economy also plays a key role in the discussions on monetary integration. The observed misalignment of the domestic business cycle with the euro area may be caused, *inter alia*, by exchange rate developments in recent years. In 2001—2002 the koruna appreciated sharply, thereby intensifying the slowdown of the economy, whereas recently the exchange rate has fostered a pick-up in growth, which is higher than the EU average. Despite the relative stability of the nominal exchange rate in the last two years, future undesirable fluctuations cannot be ruled out. The elimination of exchange rate instability by adopting the euro could therefore foster greater alignment of the Czech business cycle with the euro area. However, this benefit would be offset by costs connected with the loss of the ability to conduct independent monetary policy tailored to the needs of the Czech economy.

The structure of the Czech economy is broadly similar to that of the euro area and the EU-25. This should reduce the probability of different developments in the domestic economy and the euro area and thus be a benefit of joining the Monetary Union. However, the analyses show a lower degree of structural similarity with the euro area and the EU-25 compared to some other countries (e.g. Hungary, Portugal and Austria). Moreover, the structural differences between the Czech economy and the euro area have been widening slightly.

International relations

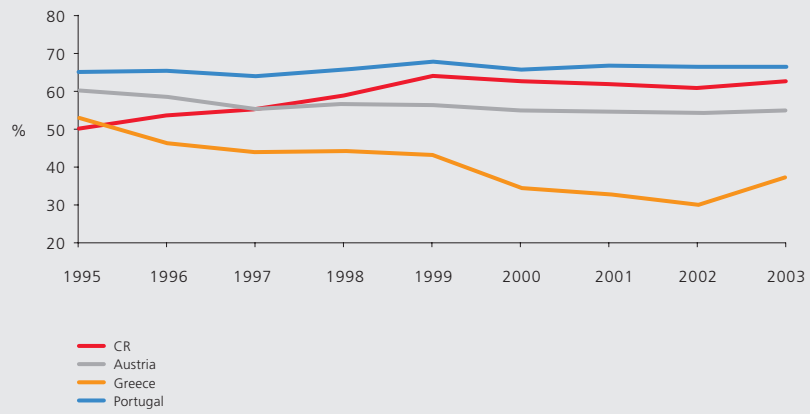
The high openness of the Czech economy is the principal argument for adopting the single currency. The share of exports of goods and services in GDP is almost 65% and the share of imports is even a little higher. In addition, these openness indicators have recently recorded further growth. Together with the strong focus of foreign trade on EU countries, this factor creates conditions for future convergence of the business cycles in the Czech Republic and the euro area and for a decline in the probability of asymmetric shocks. The high openness of the Czech economy also increases the potential benefits arising from the elimination of excessive exchange rate fluctuations against the currencies of our main trading partners.

The close trade links between the Czech Republic and the euro area and the EU-25, as measured by the shares of these two areas in our foreign trade, intensified significantly until 1999 and stabilised thereafter. Exports to the euro area currently amount to roughly 63% of total exports, while 85% of Czech exports go to the EU-25. The situation in other Central European countries is similar. All

43 The methods used were correlation analysis and VAR model analysis.

these countries thus currently have a high degree of economic integration with the euro area and the EU-25, comparable with, or in many cases even higher than, that in the existing euro area countries. Moreover, growth in Czech foreign trade with EU countries rose substantially during 2004, especially after accession to the EU.

Chart 3: The share of the EU-12 in exports from selected countries



Source: IMF

The conclusions above are in line with the results of more detailed structural analyses of foreign trade. Of the monitored countries, the structure of Czech exports is currently closest to the largest euro area economy, i.e. Germany, which is another argument for entering the euro area. So is the share of intra-industry trade between the Czech Republic and the EU, which is quite high in comparison with the selected EU member countries. As regards the goods diversity of exports and imports, the figures for the Czech Republic are comparable with other countries. Thus, the probability of asymmetric shocks is not higher than in other EU countries. Since 1995, however, this diversity has decreased on both the export side and the import side. The concentration on particular commodity groups is higher on the export side. Czech exports and imports currently focus most on the commodity groups of road vehicles and electrical equipment, machinery and appliances.

The depth and structure of financial intermediation

Differences in financial intermediation may cause similar shocks, and the ECB's subsequent single monetary policy measures, to have different impacts on individual economies. An unstable financial sector may also be a source of shocks.

The relative size of the financial sector in the Czech Republic, as measured by the ratio of assets to GDP, is one half of the European average. A more detailed look reveals that the Czech Republic is lagging well behind the euro area countries in lending. However, the Czech Republic has the most developed financial system of the new EU Member States from Central Europe. As for the representation of bank assets,

the structure of the Czech financial sector is fully comparable with the euro area financial system. The indicators of the soundness of the banking sector (see also part III.2.) have improved. Overall, we can say that the financial sector is prepared for smooth functioning in the euro area (and for standard monetary transmission). The possibility of fast future growth in lending can be regarded as a risk, but the banking sector should be able to handle this risk if the related risks are managed prudently. Lending to households is already growing fast. Similar developments have occurred in some current euro area countries (e.g. Portugal and Greece), but have so far not led to problems in their financial systems. The Czech Republic has an advantage over these countries in that its financial sector has — thanks to the finished process of reducing inflation — been operating in an environment of low nominal interest rates for a long time, and well ahead of the introduction of the single currency. This reduces the risks connected with the introduction of the euro from the point of view of macroeconomic and financial stability.

III.2. ADJUSTMENT MECHANISMS

The loss of independent monetary policy will mean that the adjustment of the economy to shocks will place higher demands on other adjustment mechanisms. This chiefly concerns the stabilisation function of public budgets, labour market flexibility and the ability of the financial system to absorb shocks.

The stabilisation function of public budgets

Compliance with the Maastricht criteria on the government deficit (3% of GDP) and debt (60% of GDP) alone will not be sufficient to ensure the stabilisation function of public finances within the European fiscal framework. It is vital to create sufficient room for manoeuvre so that government deficits under the 3% reference value are sustainable even in adverse economic conditions. The more the government can reduce the structural component of the public sector deficit, the more room will be left for the free functioning of built-in automatic stabilisers. We should mention here that the EU's fiscal rules are based on the concept of a budgetary position which is balanced or in surplus in the medium term.

The continuation of the first phase of the public finance reform and the willingness of the government to respect the set expenditure limits are a favourable factor as regards future fulfilment of the Maastricht criterion on public budget deficits and the creation of room for the stabilisation of public deficits in the future. However, the realisation of the first phase, which only targets the 3% reference value on the assumption of continuing economic growth, is a necessary, but not sufficient condition for achieving sustainable public finances (especially with regard to the ageing population) and for creating room for the stabilising function of fiscal policy. In future, problems may be caused above all by further delays in the reform of the pension and health care systems. If the second phase of the public finance reform is not implemented, adequate room will probably not be created for the stabilising function of fiscal policy after the Czech Republic's accession to the euro area. The costs of dealing with the consequent problems are sufficiently illustrated by the experience of some current euro area countries.

In addition to the government deficit, attention should be paid to government debt dynamics. The growth in debt in recent years means that the Czech Republic is forgoing the benefits of low government indebtedness. The growing debt

service costs are a mandatory expenditure and will continue to reduce the scope for the stabilising function of public budgets. Further public debt growth is therefore undesirable.

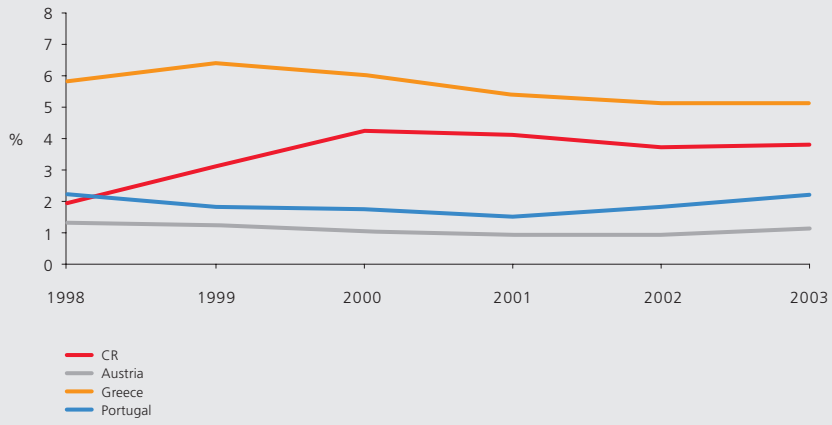
Labour market flexibility

The ability of the Czech labour market to absorb shocks is quite satisfactory by European comparison (this, however, may be a fairly low standard, because the European labour market is itself undergoing necessary structural reforms). Nevertheless, in some areas the labour market is considerably less flexible and the monitored indicators suggest a risk of further deterioration. The institutional rules on the labour market handicap above all people with low skills. The main risk factors are overall labour taxation, the interaction of taxes and social benefits and a rising minimum wage.

The flexibility of real wages in the Czech Republic is similar to that in most of the countries included in the comparison. However, this flexibility may be weakened by the marked rise in the rate of long-term unemployment which has occurred in recent years. Nevertheless, it is still true that long-term unemployment is a smaller problem for labour market flexibility in the Czech Republic than in some other countries (e.g. Poland, Slovakia and Greece). On the other hand, ever-increasing regional differences in the unemployment rate are a major problem in the Czech Republic in comparison with other countries. This may be due to significant regional gaps between demand for, and supply of, labour and the low regional mobility of the labour force. The bottlenecks include, *inter alia*, the unfinished liberalisation of the housing market.

Chart 4: Long-term unemployment

(ratio of persons unemployed for more than 1 year to the labour force)



Source: Eurostat

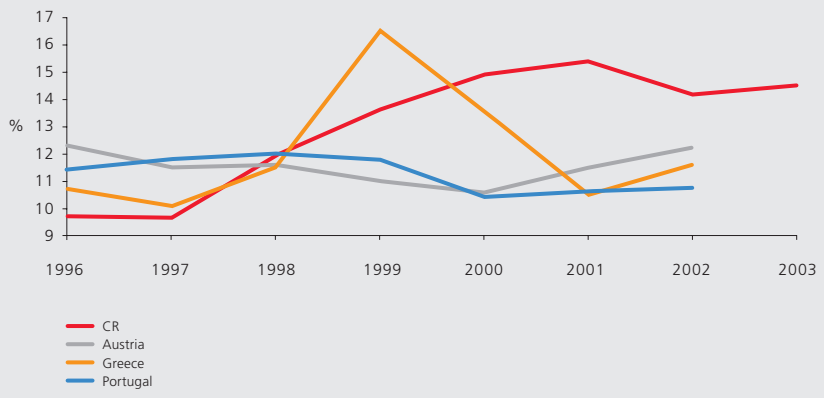
Labour market flexibility is to a great extent determined by institutional rules. The impact of the minimum wage on the flexibility of low wages and on job creation is lower in the Czech Republic than in some other countries. The minimum wage in the Czech Republic may, however, present a risk of loss of employment for a large

proportion of employees in some professions and industries. Demand for labour may also be adversely influenced by the strict conditions for the recruitment and dismissal of employees. The impact of employment protection in the Czech Republic is probably lower than in some EU countries (e.g. Greece and Portugal). However, overall labour taxation (including social security and health insurance contributions) is higher (and not decreasing) in the Czech Republic, and this is another cause of lower labour market flexibility. The Czech Republic also has the highest taxation of people with low skills, and the system of taxes and social benefits does not motivate these people to seek employment. This leaves them unemployed and forces them into the grey economy and is the primary factor behind the high structural unemployment, which significantly reduces labour market flexibility. Further reforms to increase labour market flexibility are therefore desirable. Similar efforts are also under way in other EU countries.

The performance and stability of the banking sector

Recent years have seen privatisation-related and state-supported clean-ups of banks' balance sheets and improvements in their credit portfolios. The coverage of non-performing loans by provisions in the Czech Republic is thus at a level comparable with other European countries. The capital adequacy ratio of nearly 15% indicates sufficient coverage of potential risks. The sector's resilience is moreover enhanced by high profitability. The banking sector as a whole has thus become more stable, as is also evidenced by the preliminary results of statistical simulations called "stress tests". This trend is favourable from the point of view of future entry into the euro area, because it has strengthened the ability of the financial sector to dampen potential shocks impacting on the Czech economy.

Chart 5: Capital adequacy of banks in selected countries



Source: ECB

MINUTES OF THE BOARD MEETING ON 27 OCTOBER 2004

Present at the meeting:

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

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

The inflation forecast over the short term was adjusted downwards against July. At the beginning of 2005, the CPI was expected to fluctuate near the bottom of the targeted inflation band. During the period of the most effective transmission, the inflation forecast was aimed towards the midpoint of the inflation target. Lowering the food prices forecast and postponing the expected increase in indirect taxes in 2005 for cigarettes by one quarter were the main reasons for a correction at the short end of the forecast. Demand pressures associated with the future closing of the negative output gap were predicted close to the July forecast, even though the original output gap level, in the light of published economic growth and inflation data, had increased slightly. The forecast continued to work with the limited impact on consumer inflation originating from cost pressures in the area of import prices.

The forecast confirmed the message of the two previous forecasts regarding the turn in economic activity in the first half of 2004 as well as continued acceleration of economic growth in the second half of 2004 and 2005. GDP growth was pulled by investments stimulated by rapidly growing exports. Despite a certain slowdown in 2003, private consumption had maintained relatively high dynamics. Economic growth was encouraged by eased monetary conditions and continuing foreign recovery.

The slight rise of interest rates in the longer term was consistent with the forecast. The implied interest rate trajectory was lower in comparison to the July forecast.

Following the presentation of the situational report, the Board turned to a discussion of the new forecast and the uncertainties associated with it. The Board agreed that the new forecast was consistent internally. At the same time, however, this meant a further shift towards less inflationary development with corresponding lower implied interest rates, especially in comparison to the April forecast. The changes in the economic growth forecast were, nevertheless, insignificant.

The Board said that the effect of cost factors was essential to the forecast and its risks. The economy had been recently affected by major cost shocks. Their impact on consumer inflation was, however, not yet apparent. This could be due to some cost factors operating in opposite directions. Whilst the prices of energy resources and other commodities, including metals, shifted upwards, this had been offset by the current dollar exchange rate developments. Agriculture producer prices had also started to shift downwards, with an impact on food prices. Some uncertainty was related to the speed with which these price changes should affect business contracts.

However, this situation could change quite quickly. With a longer time interval and the continued influence of cost factors, their impact on inflation could be intensified. A view was expressed that the assumption of a limited spillover of import prices into domestic price development could prove to be inadequate over the longer term. Similarly, the counter-directional agriculture price influence affecting food prices could only be temporary. Upward external cost factors could gradually start to have an impact on agriculture producer prices, which had now been influenced by this year's good harvest. Food prices should also progress in line with demand in the economy. Gradually strengthening inflation demand pressures had recently been signalled by accelerated price growth for unregulated nontradable commodities. In the longer run, certain food price growth could be expected in line with the ongoing convergence processes.

There was overall consensus that monetary policy decision-making was complicated by the fact that rising prices for energy resources and other commodities would cause a negative supply shock with possible implications for global economic growth. Cost inflation pressures associated with this development could, thereby, be reduced by the effects associated with a possible global slowdown. Slower European export growth could be an anti-inflationary risk if the euro appreciated more substantially against the dollar.

The Board also dealt with the possible effects of the expected wage acceleration in the noncorporate sector in 2005. The short-term effects on inflation would not have to be significant. In the longer term, though, wage development in the economy could be influenced more intensely. This could lead to a rise in demand and wage cost inflation pressures. The fiscal impact of this development could also play a significant role.

At the close of the meeting, the Board decided to leave the CNB two-week repo rate unchanged at 2.50%. All six board members present voted in favour of this decision.

MINUTES OF THE BOARD MEETING ON 25 NOVEMBER 2004

Present at the meeting:

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

The Board opened the meeting with a presentation of the November situational report, assessing the new information and risks associated with the October macroeconomic forecast.

Year-on-year CPI inflation reached 3.5% in October, whilst the CNB forecasted 3.2% growth. This moderate deviation was caused by an error in the forecast for food price inflation. Developments in the remaining price areas were in line with the forecast. Adjusted inflation, excluding fuel, matched the forecast exactly. Fuel prices were growing at a slower rate than the CNB had expected. Regulated prices, on the other hand, registered slightly higher growth.

The leading economic growth indicators signalled the continuation of robust recovery. The performance indicators suggested that the domestic consumption forecast had been adequately reached, nevertheless, the individual indicators of the industrial and construction sectors signalled risks of slightly lower-than-expected GDP growth in Q3 and Q4 2004. Developments on the labour market were in line with the forecast for wages as well as employment. There was uncertainty related to meeting the forecast assumption of higher wage growth in the non-corporate sector in 2005.

Following the presentation of the situational report, the Board turned to a discussion of the risks associated with achieving the October forecast in relation to inflation as well as the remaining key macroeconomic indicators. The Board agreed that there was no reason for reassessing the macroeconomic situation. The Czech economy sustained a low-inflation environment. There were no immediate risks of demand inflation pressures. However, these risks could emerge with the gradual closing of the output gap. Forecast risks were asymmetrically distributed over time. While the short-term risks associated with cost factors were rather pro-inflationary in nature, in the medium-term risks associated with demand effects were headed in an anti-inflationary direction. Some members expressed the view that the overall risks were deviating in a pro-inflationary direction.

The Board discussed the deviation in food prices from the forecasted values. Even though the predicted decline in food price dynamics occurred, from a quantitative standpoint, the forecast was not achieved. Specifically, in monthly terms, a food price decline was predicted, however in reality, these prices merely stagnated. There was consensus that the importance of the figures for one month should not be overestimated. Moreover, food prices were a volatile and difficult-to-forecast item. Nevertheless, similarly to the food prices, the forecast of a decline in agriculture producer prices was not entirely fulfilled. Some members expressed a view that the October forecast underestimated the importance of the structural change on this market in connection with the Czech Republic's EU entry. Therefore, food price development could represent a pro-inflationary risk.

However, the link between the development of agriculture producer prices and food prices would not have to be so tight. The Board would continue monitoring this issue closely.

Industrial producer price development was also perceived as a pro-inflationary risk, as well as the potentially faster transmission of import price changes into final prices. This was related to oil prices, because the projection of its future prices has been adjusted upwards in comparison to the forecast assumption. This could pose inflationary risk to the forecast that was offset partially by the weaker-than-expected dollar exchange rate. Conversely, the weaker-than-expected German data posed an anti-inflationary risk. The euro appreciating vis-à-vis the dollar was also a potential risk as far as the external demand for European goods was concerned. A slowdown in Europe would have a negative effect on exports and investments.

The Board discussed monetary conditions, which were moderately tighter against the forecast, especially due to the exchange rate component. The board members agreed that there were no fundamental reasons that could lead to a significantly stronger Czech koruna vis-ŕ-vis the euro in comparison to the forecast. In line with the approved strategic documents, the CNB was prepared to co-operate actively with the Government on eliminating any privatisation effects on the exchange rate.

At the close of the meeting, the Board decided to leave the CNB two-week repo rate unchanged at 2.50%. All seven board members present voted in favour of this decision.

MINUTES OF THE BOARD MEETING ON 22 DECEMBER 2004

Present at the meeting:

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

The Board opened the meeting with a presentation of the December situational report, assessing the new information and its implication for the risks associated with the October macroeconomic forecast. The newly available data indicated that the risks had now slightly moved in an anti-inflationary direction against to the October forecast.

November inflation at 2.9% was in line with the October forecast. Slight deviations from the forecast appeared in two price segments. Food prices rose at a faster pace than predicted in the forecast, and fuel prices rose at a slower pace than predicted. The last available inflation data were assessed as a moderate pro-inflationary risk.

Year-on-year GDP growth was lower in Q3 2004 compared to the October forecast. The revision of GDP data, which for the year 2004 changed the 2003 comparison base, played a crucial part in this deviation. Different in Q3 than predicted in the October forecast was the development in household consumption, which had grown at a slower pace than was expected, and the export of goods and services, which was higher than predicted. Leading growth indicators developed overall in line with the October forecast.

The Board followed the presentation of the situational report with a discussion. The board members agreed that the newly available data did not signal a significant accumulation of pro-inflationary nor anti-inflationary risks in connection with the October forecast. It was repeatedly said that the domestic economic environment was low-inflationary and that stable, low inflation helped anchor inflation expectations at a lower level, which at the same time helped to stabilise low inflation.

However, it was said that the anti-inflationary risks had begun to strengthen slightly. Domestic as well as foreign growth was slightly lower compared to original expectations, and therefore, no significant demand inflation pressures had surfaced in the economy. Owing to exchange rate development, a tightening of monetary conditions took place. In addition, a weaker US dollar compensated for the expected slight increase in import prices. There were opinions that even though the inflation outlook was favourable, some pro-inflationary risks did exist. The food price segment, in particular, revealed relatively dynamic price development. Oil prices in USD were still a potential inflation factor. Labour market development could also mean a pro-inflation risk.

The Board further focused on food price development. There was an opinion that faster price growth than was predicted in the October forecast could reflect the process of convergence of different price levels, which after EU entry, was accelerated by intensified exchange with abroad. It could also imply a change in the working assumption, according to which the speed of food price convergence

was mainly determined by the growth rate of the domestic population's purchasing power, and therefore, this speed was rather slow.

The Board also focused on the recent GDP figures and revision of data. It was said that the Q3 2004 GDP figures were a factor that could reduce the future GDP growth data estimate and also the inflation forecast. It was also mentioned that economic growth was still pulled by investments, but consumption growth was significantly lower than expected. One view also expressed that the significant rise in corporate lending indicated continued economic recovery. It was repeatedly said that substantial attention should be given to a more detailed analysis of the effects of the revision of GDP data on forecasting future development.

The Board also discussed the development of credit aggregates. It was said that lending growth was rather dynamic, which was triggered by an improvement in the economy in terms of the economic cycle, a low interest rate environment, and stability of the banking sector. There was also an opinion that a fast lending growth rate in the domestic non-financial business sector could pose a risk, should the position of economy worsen in terms of the economic cycle.

At the close of the meeting, the Board decided to leave the CNB two-week repo rate unchanged at 2.50%. All seven board members present voted in favour of this decision.

ANNEX OF STATISTICAL TABLES

Table 1a	Inflation development	64
Table 1b	Inflation development	65
Table 2	Consumer prices	66
Table 3	Consumer prices — tradables and nontradables	67
Table 4	Inflation expectations of selected economic sectors for 12 months ahead	68
Table 5	Harmonised index of consumer prices	69
Table 6	Monetary survey	70
Table 7	Interest rates on interbank deposits	71
Table 8	FRA rates, IRS rates	72
Table 9	Nominal and real interest rates (ex post approach)	73
Table 10	Real interest rates (ex ante approach)	74
Table 11	Koruna interest rates (stock of business)	75
Table 12	Balance of payments	76
Table 13	International investment position	78
Table 14	External debt	79
Table 15	Exchange rates	80
Table 16	Public finances	81
Table 17	Capital market	82
Table 18	CNB monetary policy instruments	83
Table 19	Macroeconomic aggregates	84
Table 20	Labour market	85
Table 21	Producer prices	86
Table 22	Ratios of key indicators to GDP	87

Table 1a

INFLATION DEVELOPMENT												annual percentage changes
2000	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**
Consumer prices	3.4	3.7	3.8	3.4	3.7	4.1	3.9	4.1	4.1	4.4	4.3	4.0
Regulated prices	7.3	7.3	7.3	7.4	7.5	7.8	6.9	7.0	7.0	7.2	7.3	7.3
(contribution to consumer price inflation)	1.94	1.95	1.96	1.98	1.99	2.09	1.87	1.90	1.91	1.98	1.99	1.97
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.32	0.32	0.32	0.14	0.14	0.14	-0.18	-0.18	-0.18	-0.18	-0.18	-0.18
Net inflation	1.6	1.9	2.1	1.7	2.1	2.6	3.1	3.2	3.2	3.5	3.4	3.0
(contribution to consumer price inflation)	1.19	1.38	1.55	1.27	1.57	1.90	2.25	2.36	2.35	2.57	2.49	2.16
of which: prices of food, beverages and tobacco	-0.6	0.0	0.1	-0.4	0.2	0.4	1.6	2.5	2.8	3.9	3.9	3.6
(contribution to consumer price inflation)	-0.16	0.00	0.02	-0.12	0.07	0.13	0.45	0.73	0.79	1.06	1.06	1.01
adjusted inflation	3.1	3.2	3.5	3.2	3.4	4.0	4.1	3.8	3.5	3.4	3.2	2.6
(contribution to consumer price inflation)	1.35	1.39	1.53	1.39	1.49	1.77	1.80	1.63	1.56	1.51	1.43	1.15
Inflation rate (annual moving average)	2.1	2.2	2.3	2.4	2.5	2.6	2.9	3.1	3.3	3.6	3.8	3.9
2001												
Consumer prices	4.2	4.0	4.1	4.6	5.0	5.5	5.9	5.5	4.7	4.4	4.2	4.1
Regulated prices	10.3	10.4	10.6	10.8	10.7	10.4	11.5	11.8	11.9	11.8	11.7	11.7
(contribution to consumer price inflation)	1.95	1.98	2.01	1.98	2.00	1.97	2.12	2.19	2.19	2.19	2.16	2.17
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	-0.18	-0.18	-0.18	0.00	0.00	0.00	0.01	0.01	0.05	0.05	0.05	0.05
Net inflation	3.0	2.9	2.9	3.3	3.8	4.4	4.7	4.1	3.1	2.7	2.4	2.4
(contribution to consumer price inflation)	2.37	2.23	2.24	2.62	2.97	3.52	3.74	3.31	2.54	2.15	1.98	1.92
of which: prices of food, beverages and tobacco	3.8	3.5	4.2	5.5	6.0	7.7	6.9	5.1	4.0	2.9	2.6	2.9
(contribution to consumer price inflation)	1.09	1.02	1.25	1.62	1.78	2.24	2.11	1.70	1.28	0.97	0.87	0.80
adjusted inflation	2.5	2.4	2.0	1.9	2.3	2.4	3.2	3.4	2.5	2.4	2.3	2.1
(contribution to consumer price inflation)	1.28	1.21	0.99	1.00	1.18	1.27	1.63	1.62	1.26	1.17	1.11	1.12
Inflation rate (annual moving average)	4.0	4.0	4.0	4.1	4.2	4.3	4.5	4.6	4.7	4.7	4.7	4.7
2002												
Consumer prices	3.7	3.9	3.7	3.2	2.5	1.2	0.6	0.6	0.8	0.6	0.5	0.6
Regulated prices	7.6	8.1	8.0	6.5	6.3	6.3	5.3	5.0	4.9	3.4	3.4	3.3
(contribution to consumer price inflation)	1.49	1.60	1.59	1.28	1.24	1.22	1.05	0.98	0.98	0.69	0.69	0.66
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.00	0.00	0.00	0.00
Net inflation	2.7	2.7	2.5	2.4	1.5	-0.1	-0.6	-0.6	-0.3	-0.1	-0.2	-0.2
(contribution to consumer price inflation)	2.20	2.15	2.01	1.89	1.20	-0.12	-0.47	-0.46	-0.22	-0.11	-0.18	-0.15
of which: prices of food, beverages and tobacco	3.2	3.0	2.3	1.7	0.6	-2.6	-3.6	-3.5	-2.9	-3.0	-3.2	-3.4
(contribution to consumer price inflation)	0.88	0.82	0.65	0.47	0.16	-0.72	-0.97	-0.96	-0.79	-0.80	-0.87	-0.93
adjusted inflation	2.5	2.5	2.6	2.7	2.0	1.1	0.9	0.9	1.1	1.3	1.3	1.5
(contribution to consumer price inflation)	1.32	1.33	1.37	1.43	1.04	0.60	0.50	0.50	0.56	0.69	0.69	0.79
Inflation rate (annual moving average)	4.6	4.6	4.6	4.5	4.3	3.9	3.5	3.1	2.7	2.4	2.1	1.8
2003												
Consumer prices	-0.4	-0.4	-0.4	-0.1	0.0	0.3	-0.1	-0.1	0.0	0.4	1.0	1.0
Regulated prices	-0.3	-0.8	-0.8	1.4	1.5	1.5	0.4	0.4	0.4	1.2	1.2	1.3
(contribution to consumer price inflation)	-0.07	-0.15	-0.16	0.29	0.31	0.32	0.08	0.09	0.08	0.24	0.24	0.27
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net inflation	-0.4	-0.2	-0.2	-0.5	-0.4	0.0	-0.2	-0.1	0.0	0.3	0.9	1.0
(contribution to consumer price inflation)	-0.32	-0.17	-0.15	-0.38	-0.30	-0.01	-0.19	-0.10	-0.01	0.20	0.70	0.77
of which: prices of food. beverages and tobacco	-4.1	-3.8	-3.5	-3.5	-2.8	-1.0	-0.9	-0.9	-0.1	0.6	2.5	2.7
(contribution to consumer price inflation)	-1.06	-1.06	-0.97	-0.94	-0.76	-0.28	-0.22	-0.22	-0.04	0.16	0.66	0.70
adjusted inflation	1.5	1.7	1.5	1.1	0.9	0.5	0.1	0.2	0.0	0.1	0.1	0.1
(contribution to consumer price inflation)	0.74	0.89	0.82	0.56	0.46	0.27	0.04	0.12	0.02	0.04	0.04	0.06
Inflation rate (annual moving average)	1.5	1.1	0.8	0.5	0.3	0.2	0.2	0.1	0.0	0.0	0.1	0.1
2004												
Consumer prices	2.3	2.3	2.5	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

CNB calculation based on CZSO data

Table 1b

INFLATION DEVELOPMENT												monthly percentage changes
2000	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**
Consumer prices	1.7	0.2	0.0	-0.1	0.2	0.6	0.6	0.2	0.0	0.3	0.1	0.2
Regulated prices	4.8	0.1	0.1	0.2	0.1	0.4	1.0	0.1	0.1	0.2	0.1	0.1
(contribution to consumer price inflation)	1.29	0.04	0.02	0.05	0.02	0.10	0.27	0.02	0.03	0.06	0.03	0.01
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.00	0.00	0.00	-0.18	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net inflation	0.6	0.2	0.0	0.0	0.3	0.7	0.5	0.2	-0.1	0.3	0.1	0.2
(contribution to consumer price inflation)	0.42	0.13	-0.01	-0.01	0.21	0.48	0.34	0.18	-0.08	0.26	0.10	0.14
of which: prices of food, beverages and tobacco	1.0	0.1	-0.6	-0.5	0.3	0.4	-0.1	0.7	0.3	1.1	0.3	0.6
(contribution to consumer price inflation)	0.30	0.03	-0.17	-0.14	0.07	0.11	-0.02	0.20	0.08	0.29	0.08	0.16
adjusted inflation	0.3	0.2	0.3	0.3	0.3	0.8	0.8	0.0	-0.4	-0.1	0.0	0.0
(contribution to consumer price inflation)	0.12	0.10	0.15	0.13	0.14	0.37	0.36	-0.02	-0.15	-0.04	0.02	-0.02
2001												
Consumer prices	1.9	0.0	0.1	0.4	0.6	1.0	1.0	-0.2	-0.7	0.0	-0.1	0.1
Regulated prices	7.7	0.3	0.2	0.3	0.0	0.1	2.1	0.3	0.2	0.1	0.0	0.0
(contribution to consumer price inflation)	1.43	0.05	0.05	0.06	0.00	0.01	0.41	0.06	0.04	0.03	-0.01	0.01
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.00	0.00	0.00	0.00	0.00	0.00	0.01	0.00	0.05	0.00	0.00	0.00
Net inflation	0.6	0.0	0.0	0.4	0.8	1.3	0.7	-0.3	-1.0	-0.1	-0.1	0.2
(contribution to consumer price inflation)	0.45	0.01	-0.01	0.31	0.57	1.07	0.56	-0.21	-0.82	-0.10	-0.05	0.10
of which: prices of food, beverages and tobacco	1.2	-0.2	0.1	0.7	0.8	2.0	-0.9	-1.0	-0.8	0.0	0.0	0.9
(contribution to consumer price inflation)	0.33	-0.06	0.03	0.19	0.23	0.56	-0.24	-0.27	-0.21	0.00	-0.01	0.24
adjusted inflation	0.2	0.1	-0.1	0.2	0.7	1.0	1.5	0.1	-1.2	-0.2	-0.1	-0.3
(contribution to consumer price inflation)	0.12	0.07	-0.04	0.12	0.34	0.51	0.81	0.06	-0.62	-0.10	-0.03	-0.14
2002												
Consumer prices	1.5	0.2	-0.1	-0.1	-0.1	-0.3	0.5	-0.2	-0.5	-0.3	-0.2	0.2
Regulated prices	3.7	0.8	0.2	-1.1	-0.1	0.0	1.1	0.0	0.1	-1.3	0.0	-0.1
(contribution to consumer price inflation)	0.75	0.16	0.04	-0.23	-0.03	0.00	0.23	-0.01	0.03	-0.26	0.00	-0.02
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net inflation	0.9	0.0	-0.2	0.2	-0.1	-0.3	0.3	-0.2	-0.7	0.0	-0.1	0.2
(contribution to consumer price inflation)	0.74	-0.03	-0.14	0.20	-0.11	-0.24	0.20	-0.19	-0.58	0.01	-0.11	0.13
of which: prices of food, beverages and tobacco	1.5	-0.4	-0.5	0.1	-0.3	-1.2	-1.9	-1.0	-0.1	0.0	-0.3	0.7
(contribution to consumer price inflation)	0.41	-0.11	-0.14	0.01	-0.08	-0.32	-0.50	-0.25	-0.03	-0.01	-0.08	0.18
adjusted inflation	0.6	0.2	0.0	0.3	-0.1	0.2	1.3	0.1	-1.0	0.0	-0.1	-0.1
(contribution to consumer price inflation)	0.33	0.08	0.00	0.18	-0.04	0.08	0.70	0.07	-0.56	0.02	-0.03	-0.05
2003												
Consumer prices	0.6	0.2	-0.1	0.2	0.0	0.0	0.1	-0.2	-0.5	0.1	0.5	0.2
Regulated prices	0.1	0.3	0.2	1.1	-0.1	0.0	0.0	0.0	0.1	-0.4	0.0	0.0
(contribution to consumer price inflation)	0.03	0.06	0.03	0.23	-0.01	0.01	0.00	0.00	0.01	-0.09	0.00	0.00
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net inflation	0.7	0.2	-0.2	0.0	0.0	0.1	0.0	-0.1	-0.6	0.3	0.5	0.3
(contribution to consumer price inflation)	0.55	0.14	-0.13	-0.03	-0.04	0.05	0.03	-0.11	-0.49	0.22	0.39	0.20
of which: prices of food, beverages and tobacco	0.8	-0.2	-0.2	0.1	0.4	0.6	-1.7	-1.0	0.6	0.7	1.6	0.8
(contribution to consumer price inflation)	0.22	-0.05	-0.05	0.04	0.10	0.16	-0.44	-0.25	0.16	0.18	0.42	0.22
adjusted inflation	0.6	0.3	-0.1	-0.1	-0.3	-0.2	0.9	0.3	-1.2	0.1	-0.1	0.0
(contribution to consumer price inflation)	0.33	0.18	-0.07	-0.06	-0.14	-0.11	0.47	0.15	-0.65	0.03	-0.03	-0.02
2004												
Consumer prices	1.8	0.2	0.1	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
(contribution 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

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 — 2000	1,000.0	1.8	2.0	2.0	1.9	2.1	2.7	3.3	3.5	3.5	3.8	3.9	4.1	2.9
Total — 2001	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
Food and non-alcoholic beverages	197.6	6.0	5.5	5.5	6.4	7.5	10.5	9.2	7.7	6.7	6.6	6.5	7.9	7.2
Alcoholic beverages and tobacco	79.2	3.4	3.9	4.3	4.6	4.9	5.0	4.9	4.9	5.2	5.5	5.6	5.4	4.8
Clothing and footwear	56.9	-3.3	-4.0	-4.0	-3.8	-3.7	-3.7	-3.9	-4.4	-4.4	-4.1	-3.8	-3.9	-3.9
Housing, water, electricity, gas and other fuels	236.4	14.2	14.4	14.6	14.8	15.1	15.4	18.4	18.6	18.8	18.9	19.0	19.0	16.8
Furnishings, household equipment and routine maintenance of the house	67.9	-0.6	-0.6	-0.5	-0.5	-0.5	-0.4	-0.4	-0.4	-0.4	-0.2	-0.3	-0.4	0.4
Health	14.3	4.7	4.9	5.1	5.3	5.4	5.7	6.5	7.5	8.6	8.9	8.3	8.4	6.6
Transport	101.4	4.9	4.8	4.7	5.8	7.5	8.7	8.2	7.6	7.8	6.5	5.3	3.4	6.3
Communications	22.5	7.2	7.1	7.1	7.0	6.8	6.7	6.6	6.5	6.0	5.9	5.8	5.7	6.5
Recreation and culture	95.5	2.7	3.4	2.9	2.3	3.3	7.0	13.7	15.3	7.1	6.5	6.8	7.2	6.5
Education	4.5	3.4	3.4	3.5	3.5	3.5	3.6	3.6	3.6	6.7	6.8	6.8	6.8	4.6
Hotels, cafés and restaurants	74.2	3.1	3.6	3.3	3.7	4.0	4.1	4.2	4.4	5.2	5.5	5.7	5.9	4.4
Miscellaneous goods and services	49.5	5.0	5.5	6.2	7.3	7.4	7.4	7.7	7.6	7.8	8.4	8.6	8.7	7.3
Total — 2002	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

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 3	2004 6	2004 9	2004 12
1. Food and non-alcoholic beverages	197.6	4.6	7.9	2.1	5.7	7.2	7.1	4.7	6.6
— tradables	197.6	4.6	7.9	2.1	5.7	7.2	7.1	4.7	6.6
2. Alcoholic beverages and tobacco	79.2	2.4	5.4	7.1	7.8	8.7	11.8	12.3	11.6
— tradables	79.2	2.4	5.4	7.1	7.8	8.7	11.8	12.3	11.6
3. Clothing and footwear	56.9	-2.7	-3.9	-7.7	-11.9	-14.3	-14.1	-15.8	-14.6
— nontradables	1.4	6.1	13.0	18.3	21.1	25.6	34.4	34.9	35.9
— tradables	55.5	-2.9	-4.3	-8.4	-12.7	-15.3	-15.3	-17.1	-15.9
4. Housing, water, electricity, gas and other fuels	236.4	7.8	19.0	24.3	26.6	30.7	29.8	30.5	32.2
— nontradables	226.1	8.1	19.7	25.2	27.5	31.6	30.8	31.4	33.2
— tradables	10.3	2.3	2.7	4.0	5.9	10.9	8.5	11.3	10.7
5. Furnishings, household equipment and routine maintenance of the house	67.9	-0.7	-0.4	-1.0	-3.0	-3.4	-3.9	-4.5	-4.9
— nontradables	2.9	4.3	7.5	9.9	12.3	14.0	16.2	16.2	16.8
— tradables	65.0	-0.9	-0.8	-1.5	-3.7	-4.2	-4.8	-5.4	-5.9
6. Health	14.3	4.1	8.4	12.8	16.4	17.4	20.7	21.7	20.6
— nontradables	11.0	4.9	10.1	15.4	19.9	21.1	25.3	26.7	25.2
— tradables	3.3	1.5	2.7	4.4	5.1	5.3	5.7	5.5	5.6
7. Transport	101.4	6.9	3.4	4.1	3.6	6.8	7.6	6.4	5.0
— nontradables	27.4	6.2	11.7	16.0	18.4	22.2	22.7	22.9	23.0
— tradables	74.0	7.2	0.3	-0.3	-1.9	1.1	2.0	0.3	-1.6
8. Communications	22.5	1.5	5.7	8.2	7.2	23.0	21.4	19.6	21.0
— nontradables	21.0	2.7	8.5	2.1	2.3	17.8	16.6	14.9	16.6
— tradables	1.5	-16.4	-34.7	95.9	77.5	96.8	89.8	86.7	83.6
9. Recreation and culture	95.5	2.0	7.2	7.2	6.1	7.6	9.1	8.9	7.9
— nontradables	60.4	4.4	14.3	16.2	16.7	19.0	22.4	22.7	21.2
— tradables	35.1	-2.2	-5.0	-8.3	-12.1	-12.0	-13.7	-14.8	-15.0
10. Education	4.5	3.4	6.8	11.3	12.0	12.5	12.8	17.9	18.1
— nontradables	4.5	3.4	6.8	11.3	12.0	12.5	12.8	17.9	18.1
11. Hotels, cafés and restaurants	74.2	2.6	5.9	8.7	10.8	12.4	17.5	18.8	19.6
— nontradables	74.2	2.6	5.9	8.7	10.8	12.4	17.5	18.8	19.6
12. Miscellaneous goods and services	49.5	3.1	8.7	11.9	15.2	18.8	20.3	20.2	20.3
— nontradables	22.0	5.7	17.5	25.8	36.4	43.7	47.7	48.1	48.4
— tradables	27.5	1.1	1.7	0.8	-1.7	-1.1	-1.5	-2.0	-2.2
Household consumer prices, total	1,000.0	4.1	8.4	9.0	10.1	12.4	13.1	12.6	13.2
Tradables	549.1	2.5	2.9	0.6	0.7	1.6	1.9	0.6	0.9
— food	276.8	4.0	7.2	3.5	6.3	7.6	8.4	6.9	8.0
— others	272.3	1.0	-1.5	-2.4	-5.0	-4.5	-4.8	-5.8	-6.3
Nontradables	450.9	6.0	15.2	19.2	21.6	25.5	26.7	27.3	28.2
— others	271.2	4.7	11.5	16.5	19.4	22.7	25.7	26.7	26.9
— regulated	179.7	8.0	20.6	23.2	24.9	29.8	28.3	28.2	30.3

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
1/00	4.0	—	—
2/00	4.5	—	—
3/00	4.5	4.3	4.1
4/00	4.2	—	—
5/00	4.1	—	—
6/00	4.4	4.8	4.1
7/00	4.6	—	—
8/00	4.5	—	—
9/00	4.7	5.0	4.6
10/00	4.6	—	—
11/00	4.8	—	—
12/00	5.0	4.7	4.1
1/01	4.5	—	—
2/01	4.3	—	—
3/01	4.2	4.2	4.0
4/01	4.0	—	—
5/01	4.3	—	—
6/01	4.6	4.8	5.1
7/01	4.6	—	—
8/01	4.7	—	—
9/01	4.8	4.7	4.9
10/01	4.4	—	—
11/01	4.0	—	—
12/01	3.9	3.9	4.6
1/02	3.8	—	—
2/02	3.5	—	—
3/02	3.5	3.6	3.9
4/02	3.5	—	—
5/02	3.3	—	—
6/02	3.1	2.7	1.6
7/02	2.8	—	—
8/02	2.7	—	—
9/02	3.1	2.4	1.3
10/02	2.5	—	—
11/02	2.4	—	—
12/02	2.3	2.3	2.3
1/03	2.5	—	—
2/03	2.4	—	—
3/03	2.5	2.1	4.3
4/03	2.6	—	—
5/03	3.7	—	—
6/03	3.2	2.6	1.7
7/03	3.3	—	—
8/03	3.2	—	—
9/03	3.1	2.6	3.1
10/03	3.0	—	—
11/03	3.1	—	—
12/03	3.3	2.9	4.2
1/04	2.9	—	—
2/04	3.2	—	—
3/04	3.0	3.3	4.9
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

Source: CNB statistical survey

Table 5

HARMONISED INDEX OF CONSUMER PRICES					annual percentage changes
	2000	2001	2002	2003	2004
	12	12	12	12	12
Belgium	3.0	2.0	1.3	1.7	1.9
Denmark	2.3	2.1	2.6	1.2	1.0
Finland	2.9	2.3	1.7	1.2	0.1
France	1.7	1.4	2.2	2.4	2.2
Ireland	4.6	4.4	4.6	2.9	2.4
Italy	2.8	2.2	3.0	2.5	2.4
Luxembourg	4.3	0.9	2.8	2.4	3.5
Germany	2.1	1.4	1.1	1.1	2.2
Netherlands	2.9	5.1	3.2	1.6	1.2
Portugal	3.8	3.9	4.0	2.3	2.6
Austria	1.8	1.8	1.7	1.3	2.5
Greece	3.7	3.5	3.5	3.1	3.1
Spain	4.0	2.5	4.0	2.7	3.3
Sweden	1.3	3.2	1.7	1.8	0.9
United Kingdom	0.9	1.0	1.7	1.3	1.6
European Union	2.2	1.9	2.2	1.8	2.2
Czech Republic	4.0	3.9	0.1	1.0	2.5

Source: Eurostat

Table 6

MONETARY SURVEY					position at month-end in CZK billions
	2000	2001	2002	2003	2004
	12	12	12	12	11
Total assets	1,412.3	1,596.0	1,651.8	1,766.1	1,839.1
Net external assets (NEAs)	673.1	800.6	926.1	821.5	912.1
NEAs of CNB	—	—	715.6	687.5	650.1
NEAs of OMFIs	—	—	210.5	134.0	262.0
Net domestic assets	739.2	795.4	725.8	944.5	927.0
Domestic loans	1,068.8	1,011.9	940.0	1,145.6	1,129.4
Net credit to government (NCG) (including securities)	—	—	215.8	354.0	241.0
NCG to central government (including securities)	—	—	260.4	408.7	309.2
NCG to other government (including securities)	—	—	-44.6	-54.8	-68.2
Loans to corporations and households (excluding securities)	963.9	775.4	724.2	791.6	888.4
Loans to corporations (excluding securities)	841.0	636.1	542.7	554.1	587.7
Loans to households (excluding securities)	122.9	139.3	181.5	237.5	300.6
Other net items (including securities and capital)	-329.6	-216.5	-214.3	-201.1	-202.3
Capital and reserves	—	—	-462.8	-398.7	-375.5
Holdings of securities	—	—	18.5	16.6	22.8
Issued securities	—	—	-48.6	-51.6	-77.6
Others	—	—	278.5	232.6	228.0
Liabilities					
Monetary aggregate M2	1,412.3	1,596.0	1,651.8	1,766.1	1,839.1
Monetary aggregate M1	497.7	583.6	787.7	902.8	975.5
Currency in circulation	171.8	180.4	197.8	221.4	238.5
Overnight deposits	—	—	589.9	681.4	737.0
Overnight deposits — households	—	—	315.6	372.1	419.2
Overnight deposits — corporations	—	—	274.3	309.3	317.8
M2—M1 (quasi money)	914.6	1,012.4	864.1	863.3	863.7
Deposits with agreed maturity	—	—	651.2	666.4	668.3
Deposits with agreed maturity — households	—	—	448.6	439.8	454.1
Deposits with agreed maturity — corporations	—	—	202.5	226.6	214.1
Deposits redeemable at notice	—	—	194.3	185.6	185.6
Deposits redeemable at notice — households	—	—	190.7	182.3	181.7
Deposits redeemable at notice — corporations	—	—	3.6	3.2	3.9
Repurchase agreements	—	—	18.6	11.3	9.8
Annual percentage changes					
M1	11.1	17.3	35.0	14.6	9.9
M2	5.6	13.0	3.5	6.9	6.6
Loans to corporations and households	-3.7	-19.6	-6.6	9.3	12.0
M2—M1 (deposits)	2.8	10.7	-14.6	-0.1	3.0
Annual percentage growth rates					
M1	—	—	—	15.5	11.4
M2	—	—	—	8.1	7.8
Loans to corporations and households	—	—	—	11.8	14.6
M2—M1 (deposits)	—	—	—	1.2	4.0

Table 7

INTEREST RATES ON INTERBANK DEPOSITS					percentages
	2000	2001	2002	2003	2004
	12	12	12	12	12
1. Average PRIBOR[1)]					
— 1 day	5.23	4.63	2.75	1.98	2.49
— 7 day	5.29	4.79	2.76	2.02	2.51
— 14 day	5.29	4.78	2.76	2.03	2.51
— 1 month	5.32	4.77	2.73	2.04	2.53
— 2 month	5.36	4.72	2.67	2.06	2.55
— 3 month	5.42	4.69	2.63	2.08	2.57
— 6 month	5.60	4.62	2.60	2.13	2.67
— 9 month	5.78	4.61	2.60	2.22	2.76
— 12 month	5.90	4.62	2.60	2.30	2.85
2. Average PRIBID[1)]					
— 1 day	5.11	4.53	2.65	1.88	2.39
— 7 day	5.18	4.69	2.67	1.92	2.41
— 14 day	5.19	4.69	2.67	1.93	2.41
— 1 month	5.22	4.68	2.64	1.94	2.43
— 2 month	5.26	4.62	2.57	1.96	2.45
— 3 month	5.31	4.59	2.54	1.98	2.47
— 6 month	5.49	4.52	2.51	2.03	2.57
— 9 month	5.67	4.52	2.51	2.12	2.66
— 12 month	5.79	4.52	2.51	2.20	2.75

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

Table 8

FRA RATES					percentages; monthly averages
	2000	2001	2002	2003	2004
	12	12	12	12	12
3 * 6	5.68	4.49	2.52	2.23	2.74
3 * 9	5.85	4.53	2.54	2.36	2.81
6 * 9	5.93	4.53	2.52	2.47	2.85
6 * 12	6.10	4.52	2.58	2.64	2.92
9 * 12	6.19	4.54	2.61	2.77	2.97
9*12—3*6 spread	0.51	0.05	0.10	0.55	0.24
6*12—3*9 spread	0.25	-0.02	0.04	0.28	0.12

IRS RATES					percentages; monthly averages
	2000	2001	2002	2003	2004
	12	12	12	12	12
1Y	5.94	4.64	2.63	2.41	2.82
2Y	6.40	4.72	2.85	2.98	3.06
3Y	6.72	4.89	3.18	3.38	3.27
4Y	6.96	5.05	3.46	3.69	3.45
5Y	7.15	5.19	3.70	3.93	3.62
6Y	7.29	5.32	3.91	4.13	3.77
7Y	7.38	5.43	4.08	4.29	3.89
8Y	7.42	5.52	4.23	4.43	4.00
9Y	7.43	5.60	4.36	4.54	4.09
10Y	7.43	5.66	4.47	4.64	4.17
15Y	—	5.85	4.77	4.97	4.40
20Y	—	—	—	5.11	4.54
5Y—1Y spread	1.21	0.56	1.07	1.52	0.80
10Y—1Y spread	1.49	1.02	1.84	2.23	1.35

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		
	2W	1Y	new loans	time deposits	2W	1Y	new loans	time deposits	2W	1Y	new client loans
1/00	5.3	5.9	7.3	4.6	1.9	2.4	3.8	1.2	1.1	1.7	3.0
2/00	5.3	6.0	7.0	4.5	1.5	2.2	3.2	0.7	0.8	1.4	2.4
3/00	5.3	5.7	7.1	4.5	1.4	1.8	3.2	0.6	0.2	0.6	1.9
4/00	5.3	5.5	7.1	4.4	1.8	2.1	3.6	1.0	1.1	1.3	2.8
5/00	5.3	5.5	7.1	4.3	1.5	1.8	3.2	0.6	0.9	1.1	2.5
6/00	5.3	5.7	6.8	4.2	1.1	1.5	2.6	0.1	0.2	0.6	1.6
7/00	5.3	5.8	6.5	4.2	1.3	1.8	2.5	0.3	0.3	0.7	1.5
8/00	5.3	5.7	6.7	4.2	1.1	1.6	2.5	0.1	0.5	0.9	1.8
9/00	5.3	5.7	6.8	4.2	1.1	1.6	2.6	0.1	-0.1	0.3	1.4
10/00	5.3	5.8	6.6	4.0	0.9	1.3	2.1	-0.3	-0.6	-0.1	0.7
11/00	5.3	5.9	6.7	4.0	1.0	1.5	2.3	-0.3	-0.6	0.0	0.7
12/00	5.3	5.9	6.8	3.9	1.2	1.8	2.7	-0.1	0.3	0.9	1.7
1/01	5.3	5.6	6.3	3.9	1.0	1.3	2.0	-0.3	1.0	1.3	2.0
2/01	5.2	5.3	6.2	3.9	1.2	1.3	2.1	-0.1	0.5	0.6	1.4
3/01	5.0	5.1	6.2	3.7	0.9	0.9	2.0	-0.3	0.9	0.9	2.0
4/01	5.0	5.0	6.2	3.7	0.4	0.4	1.5	-0.9	1.0	0.9	2.1
5/01	5.0	5.0	6.3	3.7	0.0	0.0	1.2	-1.2	1.2	1.2	2.4
6/01	5.0	5.3	6.3	3.7	-0.4	-0.2	0.7	-1.7	1.6	1.8	2.8
7/01	5.1	5.6	6.4	3.7	-0.8	-0.2	0.5	-2.1	2.0	2.6	3.3
8/01	5.3	6.0	6.6	3.7	-0.2	0.5	1.0	-1.7	2.8	3.5	4.1
9/01	5.3	5.7	6.6	3.7	0.6	0.9	1.8	-0.9	3.4	3.8	4.7
10/01	5.3	5.3	6.6	3.7	0.9	0.9	2.1	-0.7	3.9	4.0	5.3
11/01	5.2	4.9	6.3	3.6	1.0	0.7	2.0	-0.5	4.3	4.0	5.4
12/01	4.8	4.6	5.9	3.3	0.7	0.5	1.7	-0.8	4.0	3.8	5.1
1/02	4.7	4.5	5.7	3.2	1.0	0.8	2.0	-0.4	4.1	3.9	5.1
2/02	4.3	4.4	5.1	3.0	0.4	0.5	1.1	-0.8	4.4	4.5	5.2
3/02	4.3	4.5	5.3	3.0	0.6	0.8	1.6	-0.7	4.5	4.7	5.5
4/02	4.2	4.4	5.1	2.9	1.0	1.1	1.8	-0.2	4.3	4.5	5.2
5/02	3.8	4.1	4.9	2.8	1.3	1.5	2.3	0.3	4.3	4.6	5.4
6/02	3.8	3.9	5.0	2.9	2.6	2.7	3.8	1.7	4.6	4.8	5.9
7/02	3.5	3.4	4.5	2.8	2.9	2.8	3.9	2.2	4.7	4.6	5.7
8/02	3.0	3.1	4.4	2.3	2.4	2.5	3.8	1.7	4.0	4.1	5.4
9/02	3.0	3.0	4.5	2.5	2.2	2.1	3.7	1.7	4.0	3.9	5.5
10/02	3.0	2.8	4.6	2.3	2.4	2.2	4.0	1.7	3.9	3.7	5.5
11/02	2.8	2.8	4.2	2.1	2.3	2.2	3.7	1.6	3.5	3.5	4.9
12/02	2.8	2.6	4.2	2.2	2.1	2.0	3.6	1.6	3.5	3.3	4.9
1/03	2.7	2.6	4.1	2.2	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	5.6	1.6	-0.9	-0.2	2.3	-1.5	-4.7	-4.0	-1.6
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	1.7	-0.4	0.0	3.1	-1.1	-5.3	-4.9	-2.0
12/04	2.5	2.8	—	—	-0.3	0.0	—	—	-4.8	-4.5	—

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
1/00	1.3	1.8	3.2	0.6	—	—	—	—	—	—	—	—
2/00	0.8	1.4	2.4	0.0	—	—	—	—	—	—	—	—
3/00	0.8	1.2	2.5	0.0	1.0	1.3	2.7	0.2	1.1	1.5	2.9	0.4
4/00	1.1	1.3	2.8	0.2	—	—	—	—	—	—	—	—
5/00	1.1	1.4	2.8	0.2	—	—	—	—	—	—	—	—
6/00	0.9	1.2	2.3	-0.1	0.5	0.9	1.9	-0.5	1.1	1.5	2.6	0.1
7/00	0.7	1.1	1.9	-0.4	—	—	—	—	—	—	—	—
8/00	0.8	1.2	2.1	-0.3	—	—	—	—	—	—	—	—
9/00	0.6	1.0	2.0	-0.5	0.3	0.7	1.8	-0.8	0.7	1.1	2.1	-0.4
10/00	0.7	1.1	1.9	-0.5	—	—	—	—	—	—	—	—
11/00	0.5	1.0	1.8	-0.8	—	—	—	—	—	—	—	—
12/00	0.3	0.9	1.7	-1.1	0.6	1.1	2.0	-0.8	1.1	1.7	2.6	-0.2
1/01	0.8	1.1	1.8	-0.6	—	—	—	—	—	—	—	—
2/01	0.9	1.0	1.8	-0.4	—	—	—	—	—	—	—	—
3/01	0.8	0.8	1.9	-0.4	0.8	0.8	1.9	-0.4	1.0	1.0	2.1	-0.3
4/01	1.0	0.9	2.1	-0.3	—	—	—	—	—	—	—	—
5/01	0.7	0.7	1.9	-0.6	—	—	—	—	—	—	—	—
6/01	0.4	0.7	1.6	-0.8	0.2	0.5	1.4	-1.0	-0.1	0.2	1.1	-1.3
7/01	0.5	1.0	1.7	-0.8	—	—	—	—	—	—	—	—
8/01	0.6	1.2	1.8	-0.9	—	—	—	—	—	—	—	—
9/01	0.5	0.8	1.7	-1.0	0.5	0.8	1.7	-1.0	0.4	0.7	1.6	-1.1
10/01	0.9	0.9	2.1	-0.7	—	—	—	—	—	—	—	—
11/01	1.2	0.9	2.2	-0.4	—	—	—	—	—	—	—	—
12/01	0.9	0.7	1.9	-0.6	0.9	0.7	1.9	-0.6	0.2	0.0	1.2	-1.2
1/02	0.9	0.7	1.9	-0.5	—	—	—	—	—	—	—	—
2/02	0.8	0.8	1.5	-0.4	—	—	—	—	—	—	—	—
3/02	0.8	1.0	1.8	-0.5	0.7	0.9	1.7	-0.6	0.4	0.6	1.4	-0.9
4/02	0.7	0.8	1.5	-0.5	—	—	—	—	—	—	—	—
5/02	0.5	0.7	1.5	-0.5	—	—	—	—	—	—	—	—
6/02	0.7	0.8	1.9	-0.2	1.1	1.2	2.3	0.2	2.2	2.3	3.4	1.3
7/02	0.7	0.6	1.7	0.0	—	—	—	—	—	—	—	—
8/02	0.3	0.4	1.7	-0.4	—	—	—	—	—	—	—	—
9/02	-0.1	-0.1	1.4	-0.6	1.1	1.0	2.6	0.6	1.7	1.6	3.2	1.2
10/02	0.5	0.3	2.0	-0.2	—	—	—	—	—	—	—	—
11/02	0.4	0.3	1.8	-0.3	—	—	—	—	—	—	—	—
12/02	0.5	0.3	1.9	-0.1	0.5	0.3	1.9	-0.1	0.5	0.3	1.9	-0.1
1/03	0.2	0.1	1.6	-0.3	—	—	—	—	—	—	—	—
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	-1.1	-0.8	1.8	-1.7	—	—	—	—	—	—	—	—
3/04	-1.0	-0.7	2.1	-1.4	-1.2	-1.0	1.8	-1.7	-2.7	-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	2.7	-1.2	—	—	—	—	—	—	—	—
8/04	-0.4	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	—	—	-0.7	-0.3	—	—	1.0	1.3	—	—

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
	2000	2001	2002	2003	2004
	12	12	12	12	11
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	7.95
— maturity up to 1 year	—	8.20	10.35	11.21	12.81
— maturity over 1 year and up to 5 years	—	10.55	10.80	10.17	12.44
— maturity over 5 years	—	8.02	7.35	6.65	6.40
for consumption — total	—	—	13.83	13.83	14.95
— maturity up to 1 year	—	—	13.05	14.26	15.56
— maturity over 1 year and up to 5 years	—	—	14.48	13.86	15.24
— maturity over 5 years	—	—	12.55	13.21	13.41
for house purchase — total	—	—	7.11	6.31	5.97
— maturity up to 1 year	—	—	7.67	6.24	4.53
— maturity over 1 year and up to 5 years	—	—	7.90	7.05	6.58
— maturity over 5 years	—	—	6.88	6.09	5.94
other — total	—	—	6.99	7.80	7.44
— maturity up to 1 year	—	—	6.64	8.49	8.76
— maturity over 1 year and up to 5 years	—	—	6.34	8.02	7.64
— maturity over 5 years	—	—	7.61	7.02	6.63
Non-financial corporations (S.11) — total	—	6.84	5.19	4.53	4.75
— maturity up to 1 year	—	6.32	4.34	4.08	4.36
— maturity over 1 year and up to 5 years	—	6.93	5.47	4.64	4.68
— maturity over 5 years	—	7.52	6.34	5.14	5.40
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	1.38
overnight	—	1.42	0.94	0.50	0.51
with agreed maturity — total	—	3.11	2.26	2.02	2.14
— with agreed maturity up to 2 years	—	—	1.68	0.96	1.36
— with agreed maturity over 2 years	—	—	3.04	2.90	2.74
redeemable at notice — total	—	—	1.81	1.26	1.54
— redeemable at notice up to 3 months	—	—	1.93	1.67	2.01
— redeemable at notice over 3 months	—	—	1.73	0.98	1.12
repurchase agreements	—	—	—	—	—
Non-financial corporations (S.11) — total	—	1.96	1.25	0.85	1.26
overnight	—	1.00	0.94	0.64	0.75
with agreed maturity — total	—	3.62	2.16	1.50	2.08
— with agreed maturity up to 2 years	—	—	2.15	1.49	2.05
— with agreed maturity over 2 years	—	—	3.47	3.04	3.10
redeemable at notice — total	—	—	1.64	1.17	1.54
— redeemable at notice up to 3 months	—	—	1.60	1.14	1.43
— redeemable at notice over 3 months	—	—	2.26	1.32	2.22
repurchase agreements	—	—	2.42	0.75	2.54

Table 12

BALANCE OF PAYMENTS[1)] — in CZK millions

	2000 Q1—4	2001 Q1—4	2002 Q1—4	2003 Q1—4	2004[2)] Q3
A. Current account	-104,877.1	-124,478.3	-136,378.1	-157,217.9	-53,781.4
Balance of trade[3)]	-120,825.0	-116,685.0	-71,323.0	-69,392.0	-4,952.0
exports	1,121,099.0	1,269,634.0	1,254,394.0	1,371,810.0	425,312.0
imports	1,241,924.0	1,386,319.0	1,325,717.0	1,441,202.0	430,264.0
Services	54,559.8	57,984.9	21,850.8	13,236.7	4,082.8
credit	264,806.2	269,689.6	231,131.1	219,151.1	66,721.2
transport	53,734.3	57,492.3	56,560.5	60,556.3	19,211.3
travel	115,071.0	118,133.0	96,289.2	100,310.1	31,061.9
others	96,000.9	94,064.3	78,281.4	58,284.7	16,448.0
debit	210,246.4	211,704.7	209,280.3	205,914.4	62,638.4
transport	27,543.0	30,570.5	29,332.8	33,725.7	10,067.0
travel	49,370.0	52,802.0	51,549.3	54,419.2	17,873.3
others	133,333.4	128,332.2	128,398.2	117,769.5	34,698.1
Income	-52,978.4	-83,548.9	-115,615.0	-116,644.7	-54,108.6
credit	75,439.1	84,892.3	66,790.1	74,410.3	18,377.3
debit	128,417.5	168,441.2	182,405.1	191,055.0	72,485.9
Current transfers	14,366.5	17,770.7	28,709.1	15,582.1	1,196.4
credit	36,594.6	36,404.9	46,709.0	46,773.7	13,577.9
debit	22,228.1	18,634.2	17,999.9	31,191.6	12,381.5
B. Capital account	-198.2	-330.7	-119.4	-82.2	3,446.8
credit	223.4	90.4	221.0	198.2	3,637.7
debit	421.6	421.1	340.4	280.4	190.9
Total A + B	-105,075.3	-124,809.0	-136,497.5	-157,300.1	-50,334.6
C. Financial account	148,046.6	172,849.9	347,827.4	163,854.2	64,149.6
Direct investment	190,767.4	208,296.1	270,930.2	66,353.0	34,793.4
abroad	-1,653.7	-6,289.2	-6,759.3	-6,546.5	-580.5
equity capital and reinvested earnings	-1,245.9	-5,848.5	-5,376.8	-324.1	-406.5
other capital	-407.8	-440.7	-1,382.5	-6,222.4	-174.0
in the Czech Republic	192,421.1	214,585.3	277,689.5	72,899.5	35,373.9
equity capital and reinvested earnings	171,777.2	185,981.4	270,061.0	66,811.9	32,374.7
other capital	20,643.9	28,603.9	7,628.5	6,087.6	2,999.2
Portfolio investment	-68,172.9	34,857.3	-46,748.7	-37,715.0	-1,407.8
assets	-86,631.8	4,405.6	-75,602.1	-85,888.6	-5,874.7
equity securities	-44,181.0	9,447.8	-7,807.9	5,630.5	-4,863.1
debt securities	-42,450.8	-5,042.2	-67,794.2	-91,519.1	-1,011.6
liabilities	18,458.9	30,451.7	28,853.4	48,173.6	4,466.9
equity securities	23,810.9	23,203.6	-9,035.7	30,133.5	-416.3
debt securities	-5,352.0	7,248.1	37,889.1	18,040.1	4,883.2
Financial derivatives	-1,402.8	-3,220.3	-4,281.7	3,860.1	-1,155.9
assets	-4,501.6	-9,407.6	-15,458.4	7,083.7	-997.8
liabilities	3,098.8	6,187.3	11,176.7	-3,223.6	-158.1

Table 12 (continued)

in CZK millions

	2000 Q1—4	2001 Q1—4	2002 Q1—4	2003 Q1—4	2004[2] Q3
Other investment	26,854.9	-67,083.2	127,927.6	131,356.1	31,919.9
assets	35,832.1	-46,144.5	133,121.8	67,045.4	-2,684.9
long-term	21,322.2	1,325.8	28,711.4	1,115.4	-2,591.8
CNB					
commercial banks	14,362.2	-4,125.8	5,271.7	-999.9	-1,916.4
government	2,937.0	6,928.9	25,333.6	5,688.4	-64.4
other sectors	4,023.0	-1,477.3	-1,893.9	-3,573.1	-611.0
short-term	14,509.9	-47,470.3	104,410.4	65,930.0	-93.1
commercial banks	22,001.9	-45,523.2	122,163.8	44,971.2	4,390.1
government		-87.1	-2,237.4	2,193.8	5.8
other sectors	-7,492.0	-1,860.0	-15,516.0	18,765.0	-4,489.0
liabilities	-8,977.2	-20,938.7	-5,194.2	64,310.7	34,604.8
long-term	-26,212.5	-4,262.6	2,853.8	21,349.6	15,188.8
CNB	-22.8	-22.0	-20.2	-20.4	-10.1
commercial banks	-31,523.7	-7,222.2	-8,059.2	-1,663.8	1,998.8
government	-1,837.6	-5,000.8	-1,517.2	10,304.7	1,871.2
other sectors	7,171.6	7,982.4	12,450.4	12,729.1	11,328.9
short-term	17,235.3	-16,676.1	-8,048.0	42,961.1	19,416.0
CNB	-17.0	59.7	-24.3	-21.4	-1,170.7
commercial banks	-3,812.5	-35,688.6	-3,871.2	37,899.4	10,570.1
government					
other sectors	21,064.8	18,952.8	-4,152.5	5,083.1	10,016.6
Total A + B + C	42,971.3	48,040.9	211,329.9	6,554.1	13,815.0
D. Net errors and omissions,					
valuation changes	-11,378.5	19,112.1	5,615.1	6,349.3	-13,206.4
Total A + B + C + D	31,592.8	67,153.0	216,945.0	12,903.4	608.6
E. Change in reserves (- increase)	-31,592.8	-67,153.0	-216,945.0	-12,903.4	-608.6

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 30 Sep.[1]
Assets	1,448,400.7	1,544,963.0	1,579,922.9	1,527,647.8	1,568,943.9
Direct investment abroad	27,899.3	41,176.1	44,397.1	49,040.0	51,020.0
— equity capital	24,797.5	37,633.6	39,472.1	38,005.0	39,765.0
— other capital	3,101.8	3,542.5	4,925.0	11,035.0	11,255.0
Portfolio investment	180,431.3	185,138.6	274,344.7	343,854.4	350,757.9
— equity securities	92,222.9	68,675.5	86,464.7	47,337.7	59,818.1
— debt securities	88,208.4	116,463.1	187,880.0	296,516.7	290,939.8
Financial derivatives	6,347.2	15,754.8	31,213.2	24,129.5	21,152.4
Other investment	736,903.7	778,435.7	515,356.2	419,109.0	462,372.4
Long-term	315,625.5	310,133.9	179,639.6	157,598.6	152,475.4
— CNB	329.1	307.3	280.9	468.4	642.0
— commercial banks	75,537.9	79,663.7	67,966.9	66,121.3	62,127.0
— government	220,777.8	210,694.9	97,156.8	79,483.9	75,796.4
— other sectors	18,980.7	19,468.0	14,235.0	11,525.0	13,910.0
Short-term	421,278.2	468,301.8	335,716.6	261,510.4	309,897.0
— CNB	52.9	51.2	376.7	98.8	72.6
— commercial banks	314,115.3	359,638.5	213,815.4	161,140.9	194,151.4
of which: gold and foreign exchange	228,961.7	257,138.6	163,032.9	115,875.5	122,750.4
— government	—	87.1	2,324.5	130.7	23.0
— other sectors	107,110.0	108,525.0	119,200.0	100,140.0	115,650.0
CNB reserves	496,819.2	524,457.8	714,611.7	691,514.9	683,641.2
— gold	4,640.4	4,469.9	4,653.8	4,784.3	4,621.1
— SDR	7.7	31.0	137.1	238.7	83.0
— reserve position in the IMF	116.0	5,478.3	7,081.5	11,949.9	10,591.7
— foreign exchange	491,001.2	514,188.0	686,516.1	674,451.8	668,266.0
— other reserve assets	1,053.9	290.6	16,223.2	90.2	79.4
Liabilities	1,640,270.0	1,789,030.7	1,977,177.7	2,143,363.3	2,338,392.3
Direct investment in the Czech Republic	818,411.6	982,335.0	1,165,529.1	1,219,263.4	1,308,409.3
— equity capital	702,217.8	837,537.3	1,013,102.9	1,063,633.4	1,150,779.3
— other capital	116,193.8	144,797.7	152,426.2	155,630.0	157,630.0
Portfolio investment	164,592.0	180,346.2	201,120.0	248,782.8	364,481.7
— equity securities	115,670.6	128,740.1	128,097.7	165,951.0	222,281.0
— debt securities	48,921.4	51,606.1	73,022.3	82,831.8	142,200.7
Financial derivatives	5,307.9	11,495.2	22,671.9	19,448.3	19,260.6
Other investment	651,958.5	614,854.3	587,856.7	655,868.8	646,240.7
Long-term	352,323.4	332,593.2	326,321.3	355,276.9	372,361.2
— CNB	180.4	133.4	114.5	96.1	71.7
— commercial banks	84,607.4	73,688.6	63,541.0	61,454.0	59,268.0
— government	19,699.2	9,476.2	9,475.8	22,456.0	27,400.8
— other sectors	247,836.4	249,295.0	253,190.0	271,270.8	285,620.7
Short-term	299,635.1	282,261.1	261,535.4	300,591.9	273,879.5
— CNB	8.8	68.5	44.2	22.8	1,488.8
— commercial banks	226,176.2	190,487.6	176,196.2	208,534.1	147,450.7
— government	—	—	—	—	—
— other sectors	73,450.1	91,705.0	85,295.0	92,035.0	124,940.0
Net investment position	-191,869.3	-244,067.7	-397,254.8	-615,715.5	-769,448.4

1) Preliminary data

Table 14

EXTERNAL DEBT					in CZK millions
	2000 31 Dec.	2001 31 Dec.	2002 31 Dec.	2003 31 Dec.	2004 30 Sep.[1]
Debt in convertible currencies	808,122.8	811,258.1	813,305.2	894,330.6	946,071.4
of which:					
Long-term	464,323.8	465,687.8	498,833.8	538,585.7	612,424.6
By debtor					
— CNB	180.4	133.4	114.5	96.1	71.7
— commercial banks	95,737.1	88,401.4	80,063.7	76,674.1	73,121.0
— government	29,753.5	30,839.2	47,701.3	69,029.9	130,961.0
— other sectors	338,652.8	346,313.8	370,954.3	392,785.6	408,270.9
By creditor					
— foreign banks	228,709.6	229,305.5	230,589.8	246,533.0	260,701.0
— 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	87,567.7
— suppliers and direct investors	99,560.2	105,944.3	118,829.4	116,880.0	116,580.0
— other investors	65,127.1	57,185.4	77,772.7	91,393.1	147,575.9
Short-term	343,799.0	345,570.3	314,471.4	355,744.9	333,646.8
By debtor					
— CNB	8.8	68.5	44.2	22.8	1,488.8
— commercial banks	226,246.1	192,438.4	177,474.4	210,017.1	148,190.7
— government	2,115.0	465.0	761.0	710.0	3,871.5
— other sectors	115,429.1	152,598.4	136,191.8	144,995.0	180,095.8
By creditor					
— foreign banks	203,333.8	192,126.4	168,200.7	219,391.2	166,429.4
— multilateral institutions	—	—	—	—	1,481.4
— suppliers and direct investors	106,988.6	116,278.4	112,256.8	101,210.0	124,980.0
— other investors	33,476.6	37,165.5	34,013.9	35,143.7	40,756.0
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	894,330.6	946,071.4
of which:					
— long-term	473,274.7	465,687.8	498,833.8	538,585.7	612,424.6
— short-term	343,799.0	345,570.3	314,471.4	355,744.9	333,646.8
Total long-term debt	473,274.7	465,687.8	498,833.8	538,585.7	612,424.6
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	260,462.2
— liabilities of entities with majority private capital	227,885.7	262,585.5	291,508.6	316,464.8	351,962.4

1) Preliminary data

Table 15

EXCHANGE RATES					in CZK; foreign exchange market rates
	2000	2001	2002	2003	2004
A. NOMINAL RATE	**1—12**	**1—12**	**1—12**	**1—12**	**1—12**
CZK exchange rate against selected currencies					
— annual/quarterly averages					
1 EUR	35.61	34.08	30.81	31.84	31.90
1 USD	38.59	38.04	32.74	28.23	25.70
100 SKK	83.64	78.68	72.22	76.75	79.69
— monthly averages	**12**	**12**	**12**	**12**	**12**
1 EUR	34.82	32.59	31.19	32.31	30.65
1 USD	38.94	36.48	30.65	26.32	22.87
100 SKK	80.07	75.61	74.67	78.57	78.81
— last day of the month	**31 Dec.**	**31 Dec.**	**31 Dec.**	**31 Dec.**	**31 Dec.**
1 EUR	35.09	31.98	31.60	32.41	30.47
1 USD	37.81	36.26	30.14	25.65	22.37
100 SKK	79.70	74.81	75.18	78.71	78.63

B. NOMINAL EFFECTIVE RATE	**2000**	**2001**	**2002**	**2003**	**2004**
CZK nominal effective exchange rate (percentages) (2000 = 100)					
weights — foreign trade turnover	100.0	104.3	116.5	116.0	116.3
weights — foreign trade turnover SITC 5—8	100.0	104.4	116.1	115.6	115.5

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

	2000	2001	2002	2003	2004
C. REAL EFFECTIVE RATE					**11**
CZK real effective exchange rate (percentages) (2000 = 100)					
a) industrial producer prices					
weights — foreign trade turnover	100.0	104.2	115.1	111.3	117.8
weights — foreign trade turnover SITC 5—8	100.0	104.8	115.8	112.0	119.4
b) consumer prices					
weights — foreign trade turnover	100.0	105.5	116.6	112.9	114.6
weights — foreign trade turnover SITC 5—8	100.0	106.2	117.5	113.7	115.7

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
	2000	2001	2002	2003	2004
STATE BUDGET	**1—12**	**1—12**	**1—12**	**1—12**	**1—12**
Total revenue	586.2	626.2	705.0	699.7	769.2
Tax revenue	559.5	598.3	627.4	667.5	716.7
Taxes on income, profits and capital gains	87.0	147.4	159.0	172.9	180.7
Domestic taxes on goods and services	216.8	187.0	186.9	198.4	223.2
— value-added taxes	145.9	121.3	118.1	125.6	140.4
— excises	70.9	65.7	68.9	72.9	82.8
Taxes on international trade and transactions	13.6	10.0	9.8	10.2	4.9
Taxes on property	6.0	6.4	7.9	8.8	10.4
Social and health security contributions and payroll taxes	222.2	242.3	258.5	272.4	293.3
Non-tax and capital incomes and received subsidies	26.7	27.9	77.7	32.2	52.5
Total expenditure	632.3	693.9	750.8	808.7	862.9
Current expenditure	571.4	642.5	697.3	745.4	796.8
Capital expenditure	60.9	51.4	53.5	63.3	66.1
Public budgets (balance in IMF GFS methodology)	-62.0	-52.3	-11.8	-130.2	—
state budget	-46.1	-67.7	-45.7	-109.1	-93.7
local budget	-2.5	-11.2	-4.3	-2.9	—
state financial assets	-5.7	—	—	—	—
state funds	2.6	11.2	12.3	7.1	—
Land Fund	-0.5	-0.1	-0.5	-0.7	—
National Property Fund	-11.5	13.2	28.4	-27.0	—
health insurance companies	2.1	1.4	-1.2	0.1	—
others	-0.4	0.9	-0.8	2.3	—

Table 17

CAPITAL MARKET

				last day of the month in points	
	2000	2001	2002	2003	2004
A. STOCK MARKET INDICES	12	12	12	12	12
BCPP					
PX 50	478.5	394.6	460.7	659.1	1,032.0
PX-D	1,366.0	1,065.6	1,166.4	1,642.7	2,551.1
PX-GLOB	570.6	492.9	576.8	816.9	1,232.7
RM-SYSTÉM					
PK-30	724.8	593.0	672.5	947.5	1,443.5

					in CZK millions
	2000	2001	2002	2003	2004
B. TRADE VOLUMES	12	12	12	12	12
BCPP					
Monthly trade volumes	73,240.5	142,803.6	109,264.8	98,640.0	90,610.5
of which:					
a) shares	11,113.9	12,819.3	17,089.3	28,296.0	46,210.3
b) units	61.3	4.3	0.0	0.0	0.0
c) bonds	62,065.3	129,980.0	92,175.5	70,344.0	44,400.2
RM-SYSTÉM					
Monthly trade volumes	4,861.7	2,162.5	4,412.1	1,103.0	335.8
of which:					
a) shares	4,190.1	1,841.0	298.4	1,082.5	332.7
b) units	25.9	212.2	1.0	3.7	3.1
c) bonds	645.7	109.3	4,112.7	16.8	0.0

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	—	—

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 Q3
Gross domestic product					
— in CZK millions	1,576,298	1,617,894	1,641,996	1,703,024	450,943
— percentages	3.9	2.6	1.5	3.7	3.6
Final consumption					
— in CZK millions	1,180,391	1,215,582	1,255,918	1,314,720	332,086
— percentages	2.1	3.0	3.3	4.7	-0.3
of which:					
Households					
— in CZK millions	828,009	851,305	874,649	917,619	241,084
— percentages	2.9	2.8	2.7	4.9	2.0
Government					
— in CZK millions	342,498	355,593	371,673	387,305	89,325
— percentages	0.2	3.8	4.5	4.2	-5.5
Non-profit institutions					
— in CZK millions	10,026	8,793	9,506	9,834	2,776
— percentages	-0.2	-12.3	8.1	3.5	11.8
Gross capital formation					
— in CZK millions	502,489	534,349	552,819	568,314	161,928
— percentages	9.2	6.3	3.5	2.8	8.0
of which:					
Fixed capital					
— in CZK millions	481,636	507,629	524,964	550,391	155,061
— percentages	4.9	5.4	3.4	4.8	9.7
Changes in inventories					
— in CZK millions	20,688	26,627	27,731	17,824	6,839
Acquisitions less disposals of valuables					
— in CZK millions	165	93	124	99	28
— percentages	143.5	-43.8	33.0	-19.6	27.5
Foreign trade					
of which:					
Exports of goods					
— in CZK millions	969,070	1,109,034	1,175,324	1,290,442	388,861
— percentages	19.6	14.4	6.0	9.8	24.6
Exports of services					
— in CZK millions	195,044	192,798	162,181	152,396	45,971
— percentages	4.8	-1.2	-15.9	-6.0	11.8
Imports of goods					
— in CZK millions	1,085,433	1,244,593	1,302,315	1,418,104	413,790
— percentages	20.0	14.7	4.6	8.9	20.2
Imports of services					
— in CZK millions	194,949	201,328	214,620	218,726	68,545
— percentages	-1.6	3.3	6.6	1.9	14.4
Final domestic demand					
— in CZK millions	1,662,027	1,723,211	1,780,882	1,865,111	487,147
— percentages	2.9	3.7	3.3	4.7	2.7
Aggregate domestic demand					
— in CZK millions	1,682,880	1,749,931	1,808,737	1,883,034	494,014
— percentages	4.1	4.0	3.4	4.1	2.3
Gross domestic product at current prices					
— in CZK millions	2,150,058	2,315,255	2,414,669	2,550,754	702,188
— percentages	5.3	7.7	4.3	5.6	8.4

Source: CZSO

Table 20

LABOUR MARKET

					annual percentage changes
	2000	2001	2002	2003	2004
A. NATIONAL ACCOUNTS FOR THE HOUSEHOLD SECTOR	**Q1—4**	**Q1—4**	**Q1—4**	**Q1—4**	**Q3**
Current income	5.0	5.7	6.4	4.8	4.4
of which:					
— gross operating surplus and mixed income	7.2	8.3	2.4	4.6	4.5
— compensation of employees	3.8	6.8	8.5	5.8	5.7
— property income	-11.5	0.8	-0.9	-7.9	1.7
— social benefits other than social transfers in kind	9.6	4.6	8.0	3.5	2.1
— other current transfers	13.7	-9.0	4.1	9.9	-2.4
Current expenditure	7.2	6.6	8.4	7.8	4.7
of which:					
— property income	-5.7	1.7	15.1	6.0	15.7
— current taxes on income. wealth. etc.	7.1	5.9	8.2	10.2	0.8
— social contributions	8.2	6.8	8.9	6.6	7.0
— other current transfers	6.9	8.5	4.7	10.8	-4.1
Gross disposable income	4.1	5.3	5.6	3.4	4.3
Change in net equity of households in pension funds reserves	24.6	23.9	22.6	16.1	5.3
Individual consumption expenditure	6.0	6.4	3.5	5.1	5.3
Gross saving	-11.7	-4.7	31.8	-11.2	-9.1
Gross savings rate	8.77	7.93	9.90	8.51	6.03
(gross saving/gross disposable income — ratio in per cent)					

					annual percentage changes
	2000	2001	2002	2003	2004
B. AVERAGE WAGES	**Q1— 4**	**Q1— 4**	**Q1— 4**	**Q1— 4**	**Q3**
Whole-economy nominal wage	5.9	8.1	7.0	6.4	6.7
Business sector	6.9	7.7	6.3	5.5	6.4
Non-business sector	2.6	9.6	9.8	9.8	8.3
Whole-economy real wage	1.9	3.2	5.1	6.3	3.4
Business sector	2.9	2.9	4.4	5.4	3.1
Non-business sector	-1.3	4.7	7.9	9.7	4.9

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
	2000	2001	2002	2003	2004
C. UNEMPLOYMENT	**12**	**12**	**12**	**12**	**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
	2000	2001	2002	2003	2004
Industrial producer prices					
a) previous month = 100	0.4	0.1	-0.1	0.1	0.6
b) same period of last year = 100	4.9	2.9	-0.5	-0.3	5.7
c) average for 2000 = 100	0.0	2.8	2.3	1.9	7.7
d) December 1999 = 100	3.4	6.3	5.8	5.4	11.4
Construction work prices					
a) previous month = 100	0.4	0.3	0.2	0.2	0.4
b) same period of last year = 100	4.0	4.1	2.7	2.2	3.7
c) average for 2000 = 100	0.0	4.1	6.9	9.2	13.2
d) December 1999 = 100	2.3	6.5	9.3	11.7	15.8
Agricultural producer prices					
b) same period of last year = 100	9.2	8.4	-9.5	-2.9	8.1
of which:					
crop products					
b) same period of last year = 100	12.6	9.3	-4.6	-1.0	11.6
livestock products					
b) same period of last year = 100	8.0	8.0	-12.1	-4.0	6.1
Market services prices					
(excluding interest rates)					
a) previous month = 100	0.4	0.1	0.3	0.0	0.2
b) same period of last year = 100	3.4	3.9	3.2	1.6	2.3
c) average for 2000 = 100	0.0	4.0	7.3	9.0	11.5
d) December 1999 = 100	0.6	4.6	8.0	9.7	12.2

Source: CZSO

Table 22

RATIOS OF KEY INDICATORS TO GDP				percentage ratios
	2000	2001	2002	2003
State budget balance	-2.1	-2.9	-1.9	-4.3
Public budgets balance	-2.9	-2.3	-0.5	-5.1
Public debt	16.1	18.0	18.9	22.2
Debt in convertible currencies	37.6	35.0	33.7	35.0
Trade balance[1)]	-5.6	-5.0	-3.0	-2.7
Current account balance	-4.9	-5.4	-5.6	-6.2
M2	65.7	68.9	68.4	69.1

Note: ratio = indicator/GDP at current prices

1) Source: CZSO

Issued by
CZECH NATIONAL BANK
Na Příkopě 28
115 03 Praha 1
Czech Republic

Tel.: ++420 22441 3494
Fax: ++420 22441 2179
http://www.cnb.cz