INFLATION REPORT / JULY

2005

CZECH
NATIONAL BANK

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ABBREVIATIONS USED

CCA	Czech Consolidation Agency
CNB	Czech National Bank
CHF	Swiss franc
CPI	consumer price index
ČSOB	Československá obchodní banka
CZK	Czech koruna
CZSO	Czech Statistical Office
ECB	European Central Bank
EIB	European Investment Bank
ERM	Exchange Rate Mechanism
ESA	European System of National 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
GPB	UK pound
GDP	gross domestic product
HICP	Harmonised Index of Consumer Prices
IPI	industrial production index
IRS	interest rate swap
ISPA	Instrument for Structural Policies for Pre-Accession
JPY	Japanese yen
LFS	Labour Force Survey
LIBOR	London Interbank Offered Rate
LPG	Liquefied Petroleum Gas
M1	a monetary aggregate (see section III.1.1.)
M2	a monetary aggregate see section III.1.1.)
O/N	overnight
PHARE	Pologne-Hongrie Actions pour la Reconversion Economique (The EC's programme of financial and technical assistance for the countries of Central and Eastern Europe)
PPI	producer price index
PRIBID	Prague Interbank Bid Rate
PRIBOR (1W, 1M, 1Y)	Prague Interbank Offered Rate (one-week, one-month, one-year)
repo rate	repurchase agreement rate
SAPARD	Special Accession Programme for Agriculture & Rural Development
SITC	Standard International Trade Classification
SKK	Slovak koruna
USD	US dollar
VAT	value added tax
WTI	West Texas Intermediate crude oil

In 1998, the Czech National Bank switched to direct inflation targeting. In the inflation targeting regime, the central bank's communication with the public plays a significant role. One of the core elements of this communication is the publishing of regular Inflation Reports.

Sections II and III of this pivotal document provide information on monetary and economic developments over the past quarter.

Section IV moves the focus of attention from the past to the future. It acquaints readers with the forecast for the Czech economy drawn up at the start of the given quarter by the CNB's Monetary and Statistics Department. The inflation forecast and the assumptions underlying it are published with the aim of making monetary policy as transparent, comprehensible, predictable and therefore credible as possible. The Czech National Bank is convinced that credible 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.

The forecast is the key, but not the only, input to the Bank Board's decision-making. At its meetings during the quarter, the Bank Board discusses the current balance of risks and uncertainties of the forecast. The arrival of new information since the forecast was drawn up and the possibility of asymmetric assessment of the risks of the forecast and divergent views of some board members on the development of the external environment or the linkages between the various indicators within the Czech economy mean that the Bank Board's final decision need not always correspond to the message of the forecast. Information on the Bank Board's discussions over the past four months and on the reasons for its monetary policy measures in that period is given in the minutes of the Bank Board meetings at the end of this Inflation Report.

This Inflation Report was approved by the CNB Bank Board on 4 August 2005.

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

I. SUMMARY

CHART I.1

Inflation fluctuated below the lower boundary of the target band in 2005 Q2

(annual consumer price inflation; percentages)

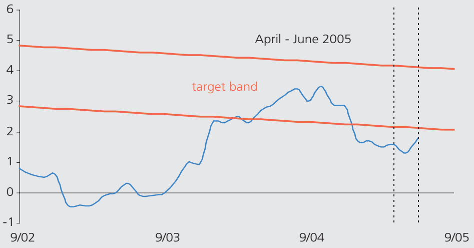


TABLE I.1

Inflation rose at the end of 2005 Q2

(annual percentage changes unless otherwise indicated)

	03/05	04/05	05/05	06/05
Consumer price inflation	1.5	1.6	1.3	1.8
Industrial producer price inflation	6.4	5.6	4.0	2.7
Money supply growth (M2)	5.3	4.7	5.4	x
3M PRIBOR[a)] (in per cent)	2.1	2.0	1.8	1.8
Nominal CZK/EUR exchange rate[a)] (level)	29.78	30.13	30.22	30.03
State budget balance since January incl. SFAOs[b)] (CZK bn)	8.2	-22.5	-27.0	3.8
GDP growth at constant prices[c)]	4.4			x
Unemployment rate (original methodology)[b)] (in per cent)	10.3	9.8	9.4	9.3

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

Annual consumer price inflation accelerated at the end of 2005 Q2. However, as in the previous quarter, inflation remained below the lower boundary of the target band (see Chart I.1). The growth rate of the Czech economy slowed slightly in 2005 Q1, but stayed above the 4% level. The situation on the labour market further improved during 2005 H1. Interest rates went on declining in 2005 Q2. Unlike in the previous quarter, the exchange rate of the koruna depreciated.

Inflation remained low in 2005 Q2, but did not develop evenly. Consumer price inflation rose slightly in April, primarily as a result of a sizeable annual increase in fuel prices, which was largely offset by a continuing moderation of food price inflation. The decline in inflation in May was due mainly to slackening annual growth in services and fuel prices together with a lower price impact of indirect taxes. Their effect on consumer prices was partly offset by faster year-on-year growth in regulated prices. The June upswing in inflation can be put down in particular to a further pick-up in annual regulated price inflation connected with a considerable increase in telecommunication services prices, and, to a lesser extent, to growth in food prices (which until then had been falling slightly year on year) and a renewed upturn in fuel price growth.

The robust growth of the Czech economy recorded in the previous two years continued into 2005 Q1, although it slowed slightly compared to the previous quarter. The growth continued to be driven primarily by a continuing sizeable lead of annual growth in goods and services exports over imports. To a lesser extent, fixed investment and household consumption also contributed to the growth of the Czech economy, although their contribution declined further in Q1. The contribution of government consumption remained negative, although, unlike in the previous year, it did not increase further.

The developments on the labour market in 2005 H1 were consistent with the phase of fast economic growth. The relatively rapid growth of the Czech economy and the favourable effects of foreign direct investment led to an upswing in employment growth, a rise in the number of vacancies and a further moderate decline in the unemployment rate. The increase in corporations' demand for labour had yet to pass through into wages in Q1, as evidenced by a further slowdown in annual nominal wage growth in the business sector. However, the sizeable decline in annual inflation generated a modest pick-up in real wage growth in this sector. Nominal and real wage growth in the non-business sector was considerably faster than in the previous quarter.

The money market saw a further fall in interest rates in 2005 Q2. The changes in rates were due primarily to the lowering of monetary policy interest rates in April. On the foreign exchange market in Q2 the koruna depreciated against the US dollar and, during the first two months, also against the euro. The main factors underlying this development were a change in investors' sentiment about the Central European region, a fall in returns on koruna investments and the appreciating dollar-euro exchange rate.

The monetary policy decision-making of the CNB Bank Board in 2005 Q2 was based on the inflation forecast discussed by the Board at its meeting on 28 April 2005. Substantial parts of this forecast were published in the April Inflation Report. Given the monetary policy transmission lag, the Board focused on hitting the inflation target in April–September 2006. According to the forecast, inflation in this period should be below the point inflation target. Consistent with the baseline scenario was a slight decline in interest rates in the period immediately ahead and flat interest rates thereafter.

At its meeting at the end of April, the Bank Board decided by a majority of the votes cast to lower the monetary policy interest rates by 0.25 percentage point with effect from 29 April 2005. This reduction was consistent with the forecast and its risks, which the Bank Board assessed as generally balanced. The main anti-inflationary risks identified by the Bank Board were the possibility of a further downturn in the economic growth of the Czech Republic's major trading partners by comparison with the assumptions of the forecast and continuing appreciation of the koruna's exchange rate. The main inflationary risks, according to the Bank Board, were the possibility of higher-than-expected oil prices and weaker pass-through of changes in the exchange rate into inflation. In the two months that followed, the Bank Board again assessed the risks of the April forecast as balanced, hence it did not make any further change to interest rates.

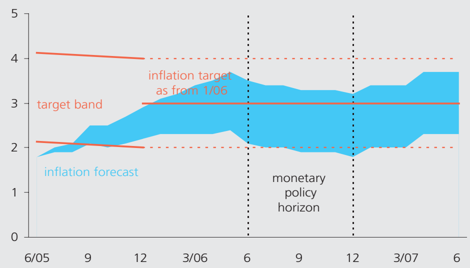
As usual, section IV of this Inflation Report describes the CNB's new forecast. The July forecast does not deviate significantly from previous forecasts, as it predicts continuing relatively high economic growth based on exports and investment. Nevertheless, the expected crossing of the potential output level is postponed to the beginning of 2007. The change to the output gap forecast relative to the April forecast chiefly reflects a lower estimate for the contribution of fiscal policy to growth this year and the next, and rather tighter monetary conditions over the next few quarters. Owing to a reassessment of the contributions of regulated prices and fuel prices, the inflation forecast has been increased over the entire forecast horizon. At the monetary policy horizon, the inflation forecast is close to the point inflation target. Consistent with the forecast and its assumptions is interest rate stability over the next several quarters and a slight rise in rates thereafter.

Along with the baseline scenario of the forecast, an alternative scenario was drawn up simulating growth in oil prices of 30% in Q3 and subsequent oil price stability at the resulting level for one year. The outcome of this simulation is an initially wider output gap and higher inflation, which implies a slightly higher level of domestic interest rates compared to the baseline scenario.

CHART I.2

The inflation forecast is near to the point inflation target at the monetary policy horizon

(annual consumer price inflation; percentages)

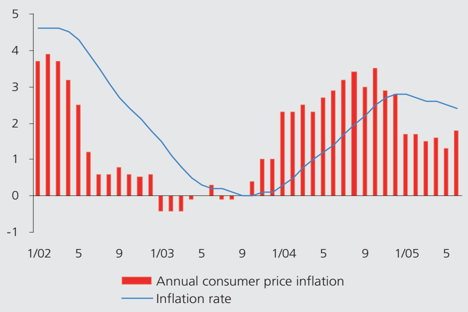


II.1 PAST INFLATION DEVELOPMENTS

Annual inflation[1] rose slightly in 2005 Q2, increasing by 0.3 percentage point compared to March to reach 1.8% in June. In May it reached its lowest level since the beginning of 2005, and in the following month it rose by 0.5 percentage point. The inflation rate[2] fell slightly to 2.4% compared to the end of 2005 Q1.

The slowdown in consumer price inflation between the end of 2005 Q1 and May manifested itself in only some components of inflation. Consumer price inflation was particularly affected by the base effect of the changes to indirect taxes implemented in May 2004, chiefly in services. Declining food price growth, closely linked with a significant fall in agricultural producer prices, also contributed to the decline in inflation in this period. The June rise in consumer price inflation was largely due to an increase in regulated prices in telecommunication services. A smaller part of the June price movement was attributable to higher food price inflation and growth in fuel prices connected with oil price developments on world markets.

CHART II.1
Annual inflation rose slightly in 2005 Q2
(percentages)



Although prices of some components of the consumer basket grew relatively fast in 2005 Q2, factors fostering continued low inflation prevailed overall in the economy. External cost inputs were strongly corrected by year-on-year appreciation of the koruna's exchange rate. Thanks to this, import prices mostly fell year on year. The only exception was import prices of energy-producing materials, which rose as a result of high growth in oil and natural gas prices on world markets. Growth in prices of imported metals, which had significantly affected industrial producer prices in Q1, eased considerably. Although according to the statistics for large non-financial corporations, the material cost-output ratio in industry increased in Q1 and was only partially offset by a falling personnel cost-output ratio and other factors, fast price growth was recorded only in industries at the initial levels of the product vertical. In industries producing products with higher value added, prices grew modestly or even fell year on year.

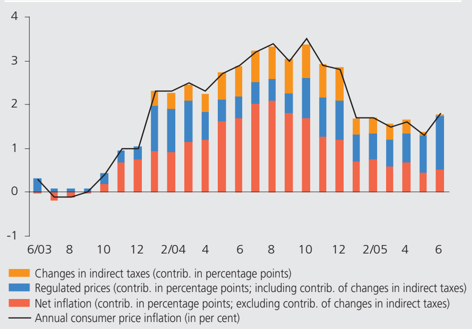
TAB. II.1
Only some of the consumer basket categories contributed to the June inflation rise
(annual percentage changes)

	12/04	1/05	2/05	3/05	4/05	5/05	6/05
Consumer prices	2.8	1.7	1.7	1.5	1.6	1.3	1.8
Food and non-alcoholic beverages	0.9	-0.5	-0.2	-0.4	-0.8	0.2	0.4
Alcoholic beverages and tobacco	3.5	3.8	3.9	3.7	2.7	1.0	0.6
Clothing and footwear	-3.1	-4.3	-4.6	-4.8	-4.5	-4.7	-4.9
Housing, water, electricity, gas and other fuels	4.4	3.5	3.4	3.4	3.6	4.0	4.0
Furnishings, household equipment and routine maintenance of the house	-2.0	-2.2	-2.2	-2.2	-2.4	-2.0	-2.1
Health	3.6	7.7	7.8	7.9	8.0	7.3	7.8
Transport	1.4	-1.8	-2.0	-2.5	0.0	-1.2	0.2
Communication	12.9	-2.6	-2.4	-2.4	-2.4	-1.3	14.2
Recreation and culture	1.7	2.2	2.5	2.3	1.8	1.8	0.9
Education	5.4	2.4	2.7	2.9	2.9	2.6	2.5
Hotels and restaurants	7.9	7.7	8.0	7.8	7.9	3.7	3.4
Miscellaneous goods and services	4,4	2.5	2.2	1.8	1.9	0.8	0.3

Developments on the demand side did not create conditions for growth in prices. Economic growth was relatively buoyant at the beginning of 2005, but the economy remained below potential output. Consumer demand growth continued to ease. Competition on the retail market remained strong. Higher inflation was also counteracted by strong foreign competition, indicated chiefly by falling prices of imports.

The aforementioned characteristics of the economic environment were reflected in market prices as measured by net inflation[3], which was moderate at the end of Q2 and, as in Q1, remained below 1% in annual terms. Within market prices, food prices rose more slowly (by 0.2% year on year), while non-food market commodities[4] grew more quickly, although their growth did not exceed 1%. As a result, their contribution to consumer price inflation at the end of 2005 Q2 was considerably lower than that of regulated prices, whose annual growth rate approached 6% (see Chart II.2).

CHART II.2
The rise in consumer prices at the end of 2005 Q2 was largely due to growth in regulated prices



1 Measured by annual growth in consumer prices.
2 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.
3 Net inflation = consumer price inflation excluding regulated prices and adjusted for other administrative measures.
4 i.e. other tradable commodities (except food and fuels) and other nontradable commodities (except regulated prices).

In 2005 Q2, growth in prices of non-food market commodities stagnated at the level reached at the end of the previous quarter (0.9% year on year). Underlying this outcome were different trends for tradable and nontradable commodities. Prices of tradable commodities, which are affected by the external competitive environment via import prices, recorded a slowing rate of annual decline compared to the end of the previous quarter (from -3.8% in March to -3.1% in June). This was due mainly to base effects caused by the changes to indirect taxes in May 2004. However, the main factor underlying the long-term decline in prices of these commodities remains the strong year-on-year appreciation of the koruna's exchange rate combined with the modest growth or decline in the prices of many consumer products on foreign markets and the tough competition on the domestic market. Prices of consumer products on the domestic consumer market declined year on year particularly in the categories of clothing and footwear and household equipment and furnishings.

Conversely, prices of nontradable commodities[5], which are affected mainly by factors of domestic origin, continued to show year-on-year growth. Compared to the previous quarter, when they increased faster than the other components of the consumer basket, their year-on-year growth slowed considerably (from 5% in March to 3.1% in June). This price change was also affected significantly by base effects due to the May 2004 changes to indirect taxes. Prices in the health category, where year-on-year growth fluctuated around 8%, recorded the fastest rise. Prices in the categories of hotels and restaurants and housing also grew faster (3.4% and 4% respectively in June). Prices in education have been showing stable year-on-year growth of over 2.4% since the beginning of 2005.

The continuing downward trend in annual food price inflation[6] and the transition to a slight decline (from 0.4% in March to -0.1% in May) continued to be associated mainly with an annual fall in agricultural producer prices and import prices of food. The gradually deepening annual decline in agricultural producer prices passed through into producer prices in the food industry and subsequently into food prices on the consumer market. Under these circumstances, food prices have been falling year on year since May (by 1.1% in June). The June increase in food prices (of 0.2% year on year) was caused by very volatile movements in fruit and vegetable prices, hence this change did not indicate any change in the current tendencies. Overall, the food price developments in the individual categories were very mixed. Prices of food produced from commodities of vegetable origin fell markedly in year-on-year comparison. Growth in other food prices was low on average.

Fuel prices were again very volatile in 2005 Q2. The large increase in prices in April (of 6.1%), following a decline in March (-1.2%), and the changing growth rates in the subsequent months of Q2 resulted from changes in oil prices on world markets, which passed through into domestic fuel prices with a short lag. However, as in the previous quarter, the annual growth of fuel prices was much lower than the growth recorded by oil prices on world markets. In addition to the sharp year-on-year appreciation of the koruna-dollar exchange rate, this difference was due to demand-side factors and probably also to strong competition between fuel sellers, which impacted on their profit margins.

Regulated prices rose relatively quickly (by 5.8%) at the end of Q2. This high year-on-year growth was a result not only of the June changes to telecommunication fees (a year-on-year increase of 18%), but also of changes to prices of regulated items implemented at the start of 2005 (electricity, heat energy, selected items in the health category, etc.).

CHART II.3

Within market prices, the fastest growth was recorded by nontradables prices, although their growth eased

(annual percentage changes, including indirect tax changes)

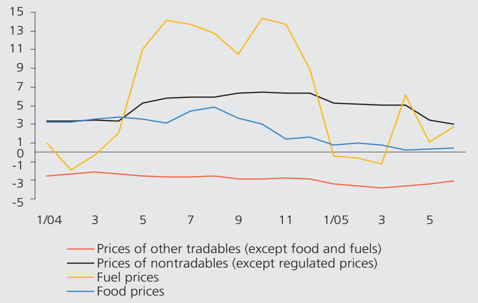


CHART II.4

Food prices mostly fell year on year in 2005 Q2

(annual percentage changes)

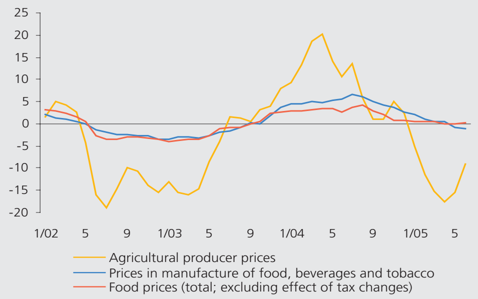
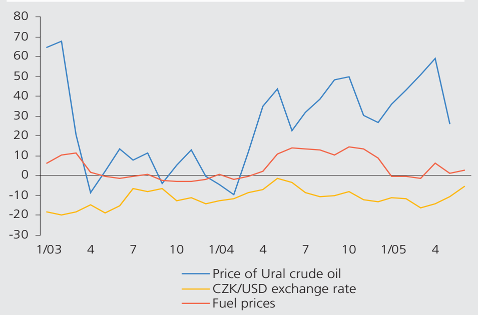


CHART II.5

The impact of the high oil prices on fuel prices was dampened by the koruna-dollar exchange rate and other factors

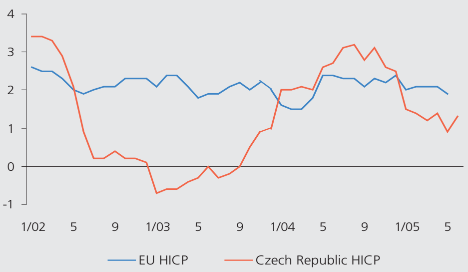
(annual percentage changes)



5 Excluding regulated prices.

6 Consolidated category of food and non-alcoholic beverages and alcoholic beverages and tobacco.

CHART II.6
Inflation in the Czech Republic was lower than in the EU Member States
(annual percentage changes)



Turning to international comparisons, annual consumer price inflation in the Czech Republic, as measured by the harmonised index of consumer prices (HICP), was below the inflation level in the EU during 2005 Q2. According to the latest figures for May, the annual HICP in the EU Member States fell slightly compared to the end of Q1 (to 1.9%). In the Czech Republic, according to the June figures, consumer price inflation as measured by the HICP was 1.3%.

BOX 1
The effect of EU accession on prices and inflation expectations

In the past, the Czech National Bank conducted analyses of the impacts of the Czech Republic's expected accession to the European Union. Some of its conclusions were published in May 2003 in a document entitled *The Impact of the Czech Republic's Accession to the European Union on Consumer Prices in the Czech Republic*. The harmonisation of indirect taxes and the integration of the Czech Republic into the Common Agricultural Policy and the Single Customs Policy of the European Union were identified as fundamental factors that could result in higher consumer price inflation. Overall, however, the CNB did not expect any sizeable price growth in connection with EU accession.

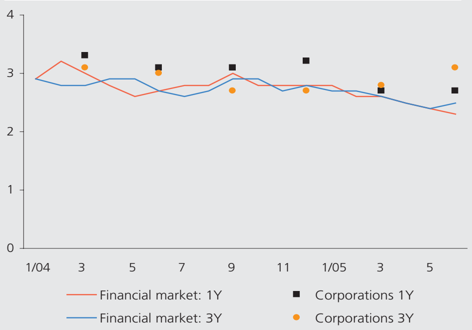
Tax changes related to EU accession were implemented in 2004. In January, excise duties were raised on fuels, cigarettes, LPG, spirits and wine and some items were simultaneously moved from the lower to the basic VAT rate, with a direct impact on consumer prices of 0.1 percentage point. In May, the basic VAT rate was lowered from 22% to 19% and some items were moved from one of the VAT rates to the other; the total direct impacts of this change amounted to about 0.2 percentage point. Overall, the direct effect of the tax adjustments was about one-third lower than originally assumed owing to a different-than-expected wording of the VAT Act.

The effects of the Czech Republic's integration into the Common Agricultural Policy on food prices had been expected to be very low. Larger price movements had been expected only for some items affected by changes in the market environment. The actual developments after EU accession essentially confirmed these assumptions. Higher growth in agricultural producer prices and subsequently in food prices was recorded primarily in the case of sugar beet and consumer prices of sugar and confectionery products (of around 10%). A further partial increase in agricultural producer prices due to the change in market environment was recorded in particular for livestock production. However, the inflationary pressures on food prices were subdued by the appreciation of the koruna-euro exchange rate from 2004 H2 onwards and by the above-average harvest in 2004. Thanks to these factors, annual food price[7] growth decreased in 2004 (from 4.6% in January to 0.9% in December).

Prior to EU accession the change in the customs system had not been expected to lead to a marked change in import prices. The situation for many food items was subject to detailed analysis, but no factors were found suggesting that the change in the customs system would have any identifiable impacts on the consumer price level in the Czech Republic. The developments to date have confirmed this conclusion.

The CNB's forecast that EU entry would have only partial price impacts has also been confirmed by the expected future inflation outturns. The CNB monitors inflation expectations of financial market participants, corporations and households at the one-year and three-year horizons (See Chart 1 Box). These inflation expectations recorded no major fluctuations at the time of the Czech Republic's accession to the EU and remained anchored close to the CNB's inflation target.

CHART 1 (BOX)
Inflation expectations were not affected by EU accession
(percentages)



[7] Excluding beverages and tobacco.

II.2 FULFILMENT OF THE INFLATION TARGET

Actual inflation was below the CNB's target band in 2005 Q2 (see Chart I.1). This section of the Inflation Report briefly analyses the contribution of the CNB's monetary policy to this situation.

Changes to interest rates pass through into inflation most strongly with a lag of around 12 to 18 months. Accordingly, to assess the effect of monetary policy on the fulfilment of the inflation target in 2005 Q2, one needs to analyse retrospectively the forecasts, and the Bank Board's decisions based thereon, dating from around October 2003 to June 2004. For comprehensibility, the analysis of the accuracy of the forecasts is limited here to a comparison of the forecast drawn up in January 2004, i.e. approximately in the middle of the aforementioned period, with inflation in 2005 Q2 (see Table II.2).

The January 2004 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. This prediction, together with the expected recovery in external economic activity, should have led to a pick-up in domestic economic growth and to closure of the output gap at the end of 2004. Changes to indirect taxes were also to join the inflationary effect of the closing output gap. The January forecast thus predicted a relatively marked pick-up in inflation and a return to the inflation target in 2004 Q2. In 2005 Q2, due to the disappearance of the year-on-year effect of the indirect tax changes, inflation was expected to be at the lower boundary of the target band. In reality, the assumption of a fast return of inflation to the target in 2004 was fulfilled, but the inflation slowdown in 2005 was more pronounced than expected. Annual consumer price inflation in 2005 Q2 was thus lower than forecasted in January (by 0.9 percentage point). A closer look at the inflation structure reveals that growth in food prices and adjusted inflation excluding fuels in 2005 Q2 was considerably lower than the forecast. Developments in the remaining price categories were slightly higher than the forecast.

The lower consumer price inflation in 2005 Q2 than forecasted in January 2004 can be put down mainly to factors lying partly or completely outside the purview of the CNB's monetary policy. These factors include in particular lower agricultural producer prices and lower external demand relative to the forecast. The anti-inflationary effect of these two factors was only partly offset by the inflationary effect of higher oil prices and higher foreign inflation (see Table II.3).

Consistent with the January forecast was interest rate stability in 2004 H1 and a modest rise in rates thereafter. In reality, the interest rate path in 2004 was broadly in line with this trajectory. In 2005, interest rates fell instead of increasing further. However, this decline was not sufficient to affect inflation significantly. In the key period as regards the most recent consumer price developments, i.e. in 2003 Q4 and 2004 H1, interest rates were roughly consistent with the forecast in both nominal and real terms. Likewise, the exchange rate forecast was broadly fulfilled in the key period, so the effect of the exchange rate component of the monetary conditions was easy and in line with the predictions of the January forecast.

During past assessments of the fulfilment of forecasts, the change in the CNB's view of the functioning of the economy since the forecast was prepared was also always discussed. As the CNB has not changed this view since January 2004, no significant change was made to the forecasting system in this period.

When assessing the fulfilment of the January forecast, one should also take into account revisions to the available economic indicators – particularly GDP – released since the forecast was drawn up. The most significant revisions to the national

TABLE II.2
Headline inflation in 2005 Q2 was lower than forecasted in January 2004
(annual percentage changes; contributions in percentage points)

	January 2004 forecast	2005 Q2 outturn	Contribution to total difference in perc. points [a]
Annual consumer price inflation	2.5	1.6	-0.9
Breakdown into contributions:			
regulated prices	2.5	4.4	0.3
indirect taxes	0.1	0.1	0.1
food prices, excluding effects of indirect taxes	2.9	0.0	-0.8
fuel prices, excluding effects of indirect taxes	-0.6	4.2	0.1
adjusted inflation excluding fuels, excluding effects of indirect taxes	2.3	0.9	-0.7

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

CHART II.7
Inflation deviated from the January 2004 forecast only in 2005
(annual percentage changes; contributions in percentage points)

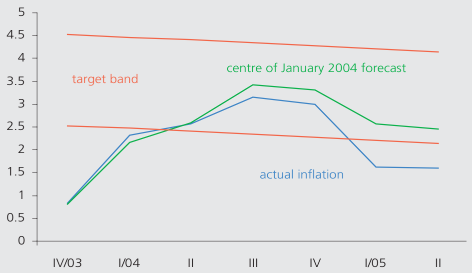


TABLE II.3
Instead of rising as expected, external demand slowed

		I/2004	II/2004	III/2004	IV/2004	I/2005	II/2005
GDP Germany [a]	prediction	1.2	1.9	2.2	2.0	2.0	2.0
(annual perc. changes)	outturn	1.8	1.9	1.2	1.3	0.7	x
CPI in Germany	prediction	0.9	1.2	1.3	1.3	1.2	1.2
(annual perc. changes)	outturn	1.1	1.8	1.9	1.9	1.7	1.7
1Y EURIBOR	prediction	2.4	2.5	2.6	2.8	3.0	3.2
(percentages)	outturn	2.1	2.3	2.3	2.3	2.3	2.2
USD/EUR exchange rate	prediction	1.28	1.28	1.27	1.27	1.26	1.25
(levels)	outturn	1.25	1.20	1.22	1.30	1.31	1.29
Oil prices [b]	prediction	28.5	25.6	25.0	24.6	24.6	24.6
(USD/barrel)	outturn	29.8	32.2	38.0	37.3	42.8	47.6

a) at constant prices, seasonally adjusted
b) Ural crude

accounts since January 2004 took place in December 2004 and June this year. Overall, these revisions did not markedly change the CNB's view of the output gap going forward. However, they did lead to an increase in the estimated growth of potential output.

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

Although the settings of the monetary conditions in the key period (October 2003–June 2004) were in line with the forecast, lower growth in external economic activity and tighter fiscal policy caused the closure of the output gap to slow in 2005 and the gap did not close fully (see Table II.4). The wider output gap and direct price impact of the koruna's appreciation at the end of 2004 and start of 2005 led to lower growth in adjusted inflation excluding fuels in 2005 Q2. This, coupled with lower food prices as a result of the above-average harvest in 2004, led to lower-than-forecasted headline inflation in the first half of this year.

TABLE II.4

Lower external demand and tighter fiscal policy led to slower closure of the output gap

		I/2004	II/2004	III/2004	IV/2004	I/2005	II/2005
3M PRIBOR	prediction	2.0	2.0	2.2	2.6	3.0	3.4
(percentages)	outturn	2.1	2.2	2.6	2.6	2.3	1.9
CZK/EUR exchange rate	prediction	32.0	32.1	32.2	32.2	32.1	31.8
(levels)	outturn	32.9	32.0	31.6	31.1	30.0	30.2
GDP	prediction	2.3	3.0	2.9	3.9	4.1	4.2
(real, annual perc. changes)	outturn	3.7	3.8	4.1	4.1	4.0	x
Output gap	prediction	-1.7	-1.4	-1.0	-0.4	0.1	0.6
(percentages of GDP)	outturn*	-1.5	-1.1	-0.9	-0.7	-0.6	-0.6

* estimate based on the CNB's July 2005 forecast

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 Q4 and 2004 H1 (see the relevant minutes), the overall perception of risks was broadly balanced. The interest rate settings ensuing from this perception were broadly in line with the message of the forecasts discussed. It is possible to say, with the benefit of hindsight, that the anti-inflationary risks materialised to a greater extent and so monetary policy could have been easier and could thus have reduced the extent of the undershooting of the inflation target in 2005 Q2.

III.1 THE EXTERNAL ENVIRONMENT

The faster growth of the US economy compared to the euro area persisted in 2005 Q1. The US dollar has been appreciating since the end of April and reached a 14-month high at the end of June. Oil prices remained the most closely followed indicator in the last half-year. In June, prices of US WTI crude oil broke through the level of USD 60 per barrel, and in 2005 Q2 its average price was 7% higher than in 2005 Q1 and 10% higher than in 2004 Q4.

Annual GDP growth in the USA reached 3.8% in 2005 Q1. Although it was lower than the figure for 2004 as a whole (4.4%), it was still at high level, helping reduce the unemployment rate and the federal government deficit, and, moreover, was considerably higher than the same indicator for the EU (1.6%) and the euro area (1.4%). Consumer spending, machinery investment and exports all rose in Q1. An increase in imports counteracted the economic growth. The USA's external imbalance remained a serious problem, as the current account deficit and trade deficit both increased as a percentage of GDP, reaching 6.4% and 5.6% respectively in Q1. After improving to USD 53.6 billion in March, the trade deficit worsened to USD 57 billion in April. The federal government budget deficit showed a significant improvement on the previous year – the deficit in May was considerably lower than in the same month of 2004 and the cumulative figure for the first eight months was roughly 20% lower than a year earlier.

The US unemployment rate in June fell to 5.0%, from 5.1% in May and 5.2% in April. Seasonally adjusted labour productivity rose by 2.9% in industry and by 4.4% in manufacturing in Q1. Consumer price inflation (2.5%) fell in June to its lowest level in nine months, while producer price inflation (3.6%) was at its second-lowest level in the same period. This fall was due in large part to a short-lived decrease in oil prices in April and May. On 30 June the Fed, in line with its strategy of "measured interest rate growth", increased its rate by 0.25 percentage point for the ninth time in a row, to 3.25%.

Annual GDP growth in the euro area was only 1.4% in 2005 Q1, meaning that the decline in output growth recorded in previous quarters continued. All components of aggregate demand, domestic and external, declined in 2005 Q1 compared to the previous period. The only component counteracting the slackening rate of growth of overall activity was lower imports. The low economic growth blocked any substantial decline in the unemployment rate, which in May fell by 0.1 percentage point relative to April to 8.8% and has remained within the range of 8.7%–8.9% for more than two years.

Although the euro area maintained a current account and trade surplus, in absolute and relative terms the surplus fell to roughly one-third of the 2004 H2 level. Consumer prices increased slightly in June (by 0.2 percentage point to 2.1%), but their growth rate remained at the level of the last four months. By contrast, producer price inflation fell by 0.8 percentage point to 3.5% in May. In this situation, there was no reason for the ECB to change its key interest rate, which has thus stayed at 2% for two years now.

Annual GDP growth[8] in Germany in 2005 Q1 was unexpectedly strong at 1.1% after seasonal adjustment. Amid declining consumption, this growth was driven by

8 Three different figures, depending on the degree of adjustment, have been published on annual GDP growth in Germany for 2005 Q1. Here we give GDP growth in 2005 Q1 compared to the same quarter of the previous year in per cent: seasonally unadjusted and unadjusted for the number of days in the quarter: 0.0%; seasonally adjusted but unadjusted for the number of days in the quarter: 0.7%; adjusted both seasonally and for the number of days in the quarter: 1.1%.

CHART III.1
Oil prices reached record highs in June 2005, the price of WTI surpassing USD 60 a barrel
(USD/barrel)

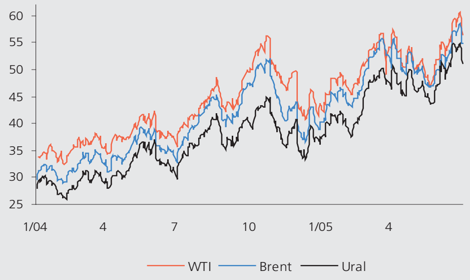


CHART III.2
The dollar strengthened considerably from May 2005 onwards, reaching a 14-month high at the end of June

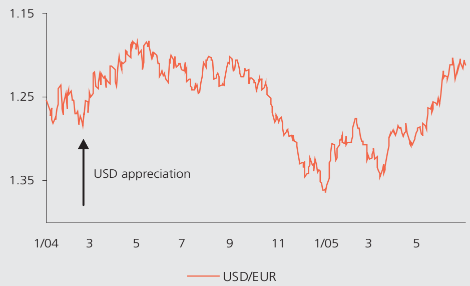
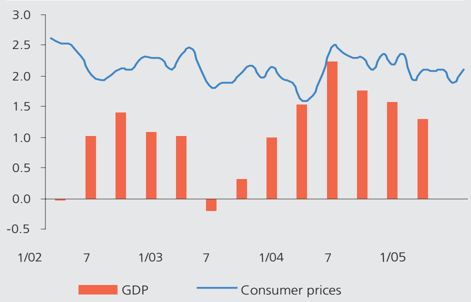


CHART III.3
Economic growth in the euro area fell again in 2005 Q1
(annual percentage changes)

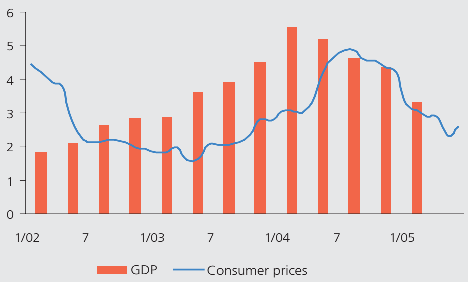


growth in investment and, in particular, net exports. The current account surplus rose to 5.3% of GDP in Q1 (from 3.8% in the previous quarter), while the trade surplus increased from 6.2% to 8.3% of GDP. The seasonally adjusted unemployment rate fell by 0.1 percentage point to 11.7% in June, but remains well above the euro area level. Consumer price inflation rose from 1.6% in May to 1.8% in June. Producer price inflation increased by 0.5 percentage point to 4.6% in May.

GDP growth in the countries of the Central European region fell in 2005 Q1 relative to the previous period, but it still remained far above the average growth in the euro area. Consumer prices developed favourably in all countries. In Hungary and Slovakia they have been falling dramatically for more than a year.

The Hungarian economy grew by 2.9% year on year in 2005 Q1, compared to 3.9% in the previous quarter. Domestic demand rose at a faster pace than in the previous quarter, but household consumption growth was still very sluggish. The low growth in personal consumption can be explained by slow real wage growth (2%–3%), high interest rates and rising unemployment. Net exports also deteriorated. The unemployment rate, which reached 7.2% in April, rose for the tenth consecutive month and was 1.2 percentage points lower a year earlier. The consumer price inflation fell to 3.6% in May from 3.9% in April, but rose again in June to 3.8%. Producer price inflation increased. In 2005 Q2, average producer price inflation was 1.3 percentage points higher than in 2005 Q1 and 2.9 percentage points higher than in 2004 Q4. Overall macroeconomic developments enabled the Hungarian central bank to lower its key rate in three steps from 7.75% to 7.0% during 2005 Q2.

Chart III.4
Although GDP is growing much faster in the "new" EU Member States than in the euro area, this growth has been slowing for a year now
(percentages)



The growth of the Polish economy declined to 2.1% in the first quarter of 2005. This poor result was due to low investment and personal consumption growth and was the third consecutive fall in growth, from 6.1% in 2004 Q2. The May industrial production growth figure, which was only 0.9%, confirmed the loss of growth in economic activity. Declining demand pressures and the unwinding of the one-off effect of EU accession led to a fall in consumer price inflation. The increase of 1.4% in the level of consumer prices in June constituted the seventh consecutive fall in their growth rate. Producer price inflation, which decreased by 0.5% in May, has been falling for a full year. Despite the slower economic growth, the unemployment rate fell to 18.3% in May, from 18.8% in April and 19.6% a year earlier. The signals from the external sector were mixed. The April current account surplus of more than EUR 500 million was followed by deficit of over EUR 700 million in May. At the end of June, the Polish central bank responded to the fall in output growth and inflation by lowering its key rate by 0.5 percentage point to an all-time low of 5%.

The Slovak economy grew at an annual rate of 5.1% in 2005 Q1. Although the growth was down by 0.7 percentage point from the previous quarter, Slovakia remained the fastest growing economy in the region. The high economic growth was due to higher domestic demand, particularly household consumption, resulting, in turn, from a marked increase in real wages, and to investment, which was positively affected by inflow of foreign capital. Slovakia's external imbalance increased. Its trade deficit decreased to SKK 4.4 billion in May from SKK 6.7 billion in April, but import growth (5.5%) has constantly exceeded export growth (0.8%) since the start of the year. In May, retail sales growth picked up to 9.6%, compared to 6.8% in April. Unemployment fell to 11.3% from 11.9% in the same period and from 14.5% a year earlier. Although consumer price inflation increased by 0.1 percentage point to 2.5% in June relative to May, it was down significantly compared to both December (5.9%) and June 2004 (8.1%). In contrast, producer prices increased by 3.9% in May, compared to 3.5% in April, owing to energy prices and a stronger dollar exchange rate.

III.2 INTEREST RATES AND THE EXCHANGE RATE

The settings of the real monetary conditions in 2005 Q2 can be characterised as slightly easy. The interest rate component was slightly easy, whereas the exchange rate component was neutral[9]. The evolution of the interest rate and exchange rate components of the monetary conditions in 2005 Q2 is described in more detail below.

III.2.1 The interest rate component of the monetary conditions

Interest rates continued to fall gradually at all maturities in 2005 Q2. The main reason for this was a decrease in the CNB's key rates and subsequent comments from the CNB's Bank Board meetings. Effective 29 April 2005, the 2W repo rate was set at 1.75%, the Lombard rate at 2.75% and the discount rate at 0.75%.

Other factors underlying the fall in interest rates included a relatively strong koruna, the inflation figures and the absence of demand-pull inflationary pressures in the Czech economy. Money market rates declined by 0.3–0.4 percentage point, with medium-term and long-term rates falling by as much as 0.6 percentage point. Their evolution was partly influenced by interest rate developments on foreign markets, which reflected concerns about a further slowdown in euro area economic growth. This increased the probability of the ECB reducing its key interest rates. PRIBOR spot quotations and FRA forward quotations at the end of June 2005 indicated that the majority of the financial market expected interest rate stability at least until the end of 2005.

The PRIBOR yield curve gradually shifted to a lower level, while its slope changed from negative to neutral. The spread between the 1Y PRIBOR and the 2W PRIBOR was zero in June. The IRS yield curve also moved to a lower level, but its slope remained positive. The average 5Y-1Y spread was 0.90 percentage point and the 10Y-1Y spread 1.55 percentage points in June.

The interest rate differential (PRIBID/CZK-LIBOR/EUR,USD) was affected by changes in key rates and movements in interbank market rates. Key rates in the two most important economies developed differently. The Fed continued raising rates (O/N rate: 3.25%), whereas the ECB kept its rates unchanged (main refinancing rate: 2.0%). The interest rate differential vis-à-vis euro and dollar rates was negative at all maturities.

Four auctions were held successfully on the primary government bond market, with original maturities of 5Y and 10Y and a total volume of CZK 36.9 billion. Demand 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, even organising one extraordinary auction.

The decline in interest rates on the financial market was also partly reflected in client interest rates. Nominal interest rates on new loans fell slightly, to 5.8% in May. Rates on new time deposits declined to 1.4%.

Real interest rates[10] are affected not only by the level of nominal rates, but also by movements in inflation expectations. Expected consumer price indices are

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

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

CHART III.5

The CNB lowered key interest rates

(percentages)

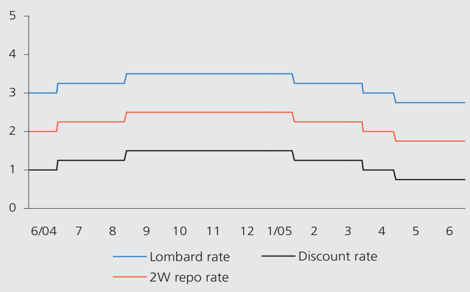


CHART III.6

Market interest rates declined

(percentages)

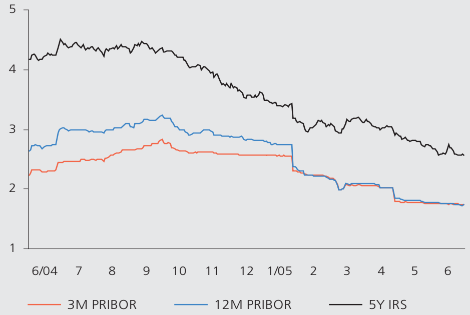


CHART III.7

The interest rate differentials fluctuated in negative values

(percentage points)

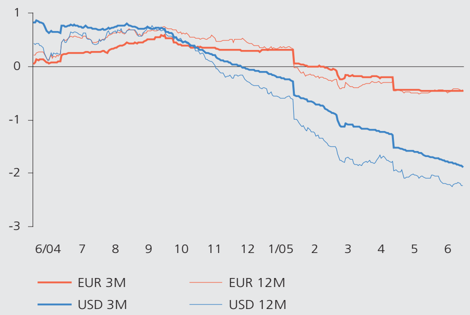
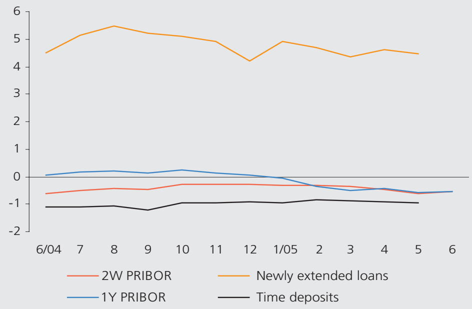


CHART III.8

Ex ante real interest rates were little changed

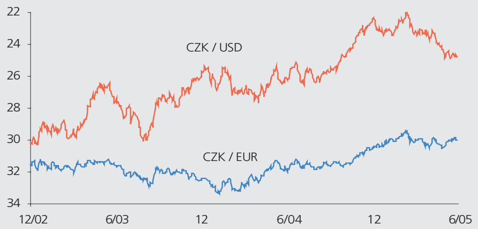
(percentages)



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 4.5% in May, while real rates on time deposits were -0.9%.

III.2.2 The exchange rate

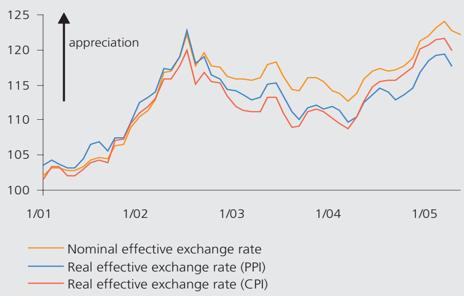
CHART III.9
The koruna depreciated against the dollar in 2005 Q2



The average exchange rate of the koruna against the euro in 2005 Q2 was CZK 30.13/EUR, which represents a year-on-year appreciation of almost 5.9% (but a moderate quarter-on-quarter depreciation of 0.4%). The appreciation trend visible since 2004 Q2 thus came to a halt. Foreign investors' sentiment about the Central European region remained the main factor underlying exchange rate developments. The view of foreign short-term investors regarding the development of currencies in Central Europe changed, probably owing to interest rate declines in the region (or the evolution of the interest rate differential against the main currencies) and the extent of the previous appreciation. Domestic factors, especially the extraordinarily favourable balance of trade and the increased inflow of foreign direct investment due to renewed sales of assets to non-residents (Unipetrol, Nova, Telecom), did not have a significant impact on the exchange rate[11]. On the other hand, it is apparent that the similar movements in the exchange rates of the region's currencies are occurring amid markedly different interest rate differentials (the Czech koruna has a slightly negative interest rate differential against the euro at maturities of up to one year, whereas the Hungarian forint, for instance, has a positive interest rate differential against the euro of around 5 percentage points).

The average exchange rate of the koruna against the dollar in 2005 Q2 was CZK 23.93/USD, which represents a year-on-year appreciation of almost 10% (but a quarter-on-quarter depreciation of almost 5%). In addition to the aforementioned change in foreign short-term investors' sentiment about the Central European region, the halt in the long-term trend of the koruna's appreciation against the dollar (from October 2000 until March 2005) and its depreciation in 2005 Q2 were caused primarily by a change in the dollar's exchange rate on world markets. This is related mainly to gradual shifts in the interest rate differentials against other major world currencies (EUR, JPY, GBP, CHF) in favour of the dollar as a result of rising interest rates in the United States.

CHART III.10
The nominal effective exchange rate recorded slower year-on-year growth in 2005 Q2
(Year 2000 = 100)



The nominal effective exchange rate of the koruna appreciated by about 5.9% year on year in 2005 Q2 (compared to just 4.3% in June 2005), owing mainly to the koruna's year-on-year 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. Compared to the previous quarter, however, the year-on-year appreciation of the koruna's nominal effective exchange rate slowed significantly, primarily owing to the appreciating dollar. The movements in the koruna's nominal exchange rate were also reflected in a slowing year-on-year appreciation of the CPI-deflated real effective exchange rate. The CPI-deflated real effective exchange rate recorded slower annual growth of 6.7% in April 2005. Conversely, the PPI-deflated real effective exchange rate appreciated more sharply compared with the previous quarter (by 8.6% year on year in April) as a result of a relatively marked slowdown in annual growth of domestic industrial producer prices at the beginning of 2005.

[11] The proceeds from the sale of the state's majority stake in Český Telecom (equivalent to CZK 82.6 billion) did not affect the koruna's exchange rate, because they were – in line with a previous statement – deposited on a privatisation account at the CNB or purchased by the CNB.

III.3 THE BALANCE OF PAYMENTS

III.3.1 The current account

In 2005 Q1, the current account ended in a surplus of CZK 14.6 billion, or 2.1% of GDP. This was the first current account surplus since 1994. The year-on-year improvement in the current account amounted to CZK 28.3 billion. This reflected above all an improving trade balance (its surplus increased by CZK 18.1 billion year on year) and a one-off effect related to damages of CZK 12.6 billion paid to ČSOB by the Slovak Republic. Other changes were insignificant.

The trade surplus amounted to CZK 19.4 billion in 2005 Q1. The balance of trade continued to be affected by favourable prices (an annual improvement in the terms of trade of 1.3% in 2005 Q1). The growth rate of exports slowed, but remained relatively high at 16.5% year on year. The improving trade balance continued to reflect primarily changes on the supply side connected with foreign direct investment and the transfer of production (chiefly of mechanical and electrical engineering commodities) from other countries to the Czech Republic. As regards the goods structure, a trade balance improvement was recorded particularly in the SITC 7 category (machinery and transport equipment), where it amounted to CZK 25.8 billion. This improvement, however, was offset by a deterioration of CZK 6.6 billion in the SITC 3 category (mineral fuels). Around one-half of this was caused by a price effect related to year-on-year growth in the prices of oil and natural gas, while the rest was due mainly to an increase in the physical volume of imports. The changes in other groups were rather insignificant. From the geographical perspective, the trade balance improvement was again due to an increase in the trade surplus with the EU (25), which grew by CZK 20.4 billion to CZK 83.3 billion. The trade balance with the United States and Russia deteriorated.

The surplus on services was virtually unchanged in year-on-year terms and amounted to CZK 1.7 billion. An annual increase in surplus was apparent especially in transport (particularly air transport), but this was offset by a deterioration on the other services balance (due to a payment for the lease of fighter aircraft).

The income deficit was virtually flat year on year at CZK 18.1 billion. It mostly consisted of reinvested earnings of non-residents in the Czech Republic of CZK 16.7 billion.

Current transfers ended in a surplus of CZK 11.7 billion, up by CZK 10.5 billion on a year earlier. However, this improvement was due exclusively to damages paid by the Slovak Republic to ČSOB for losses dating from the division of Czechoslovakia under an international arbitration decision (CZK 12.6 billion). ČSOB kept these funds in Slovakia. Adjusted for this operation, current transfers recorded a moderate year-on-year deterioration due exclusively to a one-off excess of expenditure associated with EU membership over revenues.

BOX 2
Foreign trade in the first year after the Czech Republic's accession to the EU

The development of foreign trade between May 2004 and April 2005, i.e. for the 12 months following the Czech Republic's accession to the EU, can be characterised by a significant year-on-year improvement in the trade balance, which reached positive figures, and fast growth in foreign trade turnover, particularly exports of goods.

From May 2004 to April 2005, the annual moving trade balance showed a surplus of CZK 11.2 billion, an increase of CZK 78.5 billion year on year. Exports of goods in this period rose by 23.8%, whereas imports of goods increased by 17.5%. Foreign trade turnover grew fastest during the first six months after accession (growth in exports

TABLE III.1
The current account changed into surplus due to an improvement in the trade balance
(CZK billions)

	2002 Q1	2003 Q1	2004 Q1	2005 Q1
A. Current account	-21.5	-6.9	-13.7	14.6
Trade balance	-9.2	-4.5	1.2	19.4
Services	9.2	3.2	1.8	1.7
Income	-23.9	-15.0	-18.0	-18.1
Transfers	2.4	9.4	1.2	11.7
B. Capital account	0.0	0.0	0.4	1.4
C. Financial account	54.3	34.1	5.3	-14.9
Direct investment	27.8	27.0	28.1	28.6
Portfolio investment	7.8	-32.7	25.6	-20.5
Financial derivatives	-0.1	-0.6	-0.3	-0.5
Other investment	18.8	40.5	-48.1	-22.4
D. Errors and omissions	18.9	14.9	14.9	2.1
Change in reserves (- = increase in reserves)	-13.9	-12.3	-6.9	-3.2

CHART III.11
The trade surplus increased significantly year on year in 2005 Q1
(CZK billions)

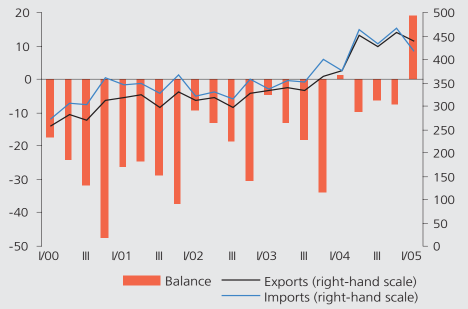


CHART III.12
The income deficit stagnated year on year in 2005 Q1
(CZK billions)

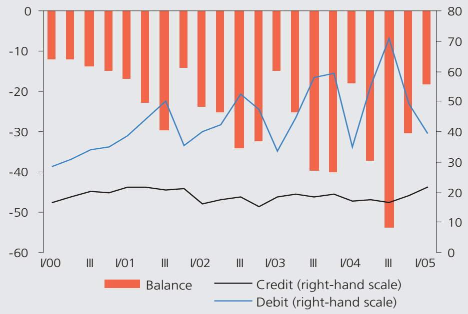
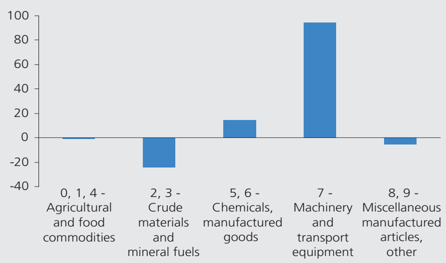


CHART 1 (BOX)
Year-on-year growth in goods exports and imports was very high in the initial months after accession
(percentages)

CHART 2 (BOX)
The year-on-year improvement in the trade balance was mainly due to machinery and transport equipment
(year-on-year changes in balance by SITC commodity group; May 2004 - April 2005; CZK billions)



exceeded 30% and growth in imports rose by almost 26%), when continuing positive changes on the supply side were accompanied by the favourable influence of growing external demand and expectations of further global economic growth. The lifting of the remaining customs barriers to trade with the EU, which had an impact on the realisation of postponed transactions, also played a role. By contrast, a more considerable year-on-year improvement in the trade balance was apparent in the second half of the period under review, when it improved by CZK 56.4 billion. In the first months following EU accession its development was to a certain extent positively influenced by the fact that importers, who expected stricter customs measures affecting imports of some commodities from third countries, increased their stocks in advance.

However, the year-on-year improvement in the trade balance was not visible in all commodity groups and was linked primarily with a sharp increase in the surplus on machinery and transport equipment. The surplus on machinery amounted to CZK 173.8 billion, up by CZK 94.5 billion on a year earlier. Within this category, three subcategories contributed to this improvement most significantly – road vehicles, electrical machinery, apparatus and appliances, and general industrial machinery and equipment, whose overall balance improved by almost CZK 71 billion year on year. The improvement in the trade balance was counteracted by a widening deficit in the mineral fuels category (up by CZK 21.6 billion to CZK 83.9 billion) resulting from increasing prices of oil and natural gas. The annual changes in balance on the remaining eight SITC categories were less significant (in the order of CZK billions). Their overall balance improved by just CZK 5.5 billion year on year, ending in a deficit of CZK 78.7 billion. They accounted for almost one half (48.5%) of the overall foreign trade turnover in the given period. The categories containing agricultural and food commodities, where trade was affected most by the changes in the customs regulations, did not record a significant change in balance either.

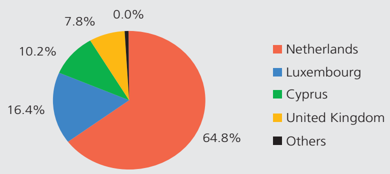
These developments show that the direct impact of the Czech Republic's accession to the EU (the changes in the customs regulations and the simplification of administrative work at borders) was not central to the improvement in the trade balance. Positive effects from the inflow of foreign direct investment remained the decisive factor. The indirect impact of EU accession, which meant that the Czech Republic entered Europe's community of advanced market economies, seems to have been more important. In addition to the primary requirement of cost minimisation, this fact could also be a factor behind the significant transfer of production from Western Europe to the Czech Republic, which considerably contributed to the improvement in the trade balance in the second half of the period under review.

III.3.2 The capital account

The capital account ended in a surplus of CZK 1.4 billion, which broadly corresponded to a subsidy from the European Fund for Regional Development. The inclusion of some EU subsidies in the capital account resulted in increased significance of this component of the balance of payments, which had previously been virtually negligible.

III.3.3 The financial account

CHART III.13
Firms registered in the Netherlands were the largest foreign investors in 2005 Q1
(percentages)



The financial account recorded a deficit of CZK 14.9 billion in 2005 Q1 (compared to a surplus of CZK 5.3 billion in the same period of 2004). This was largely due to a change in portfolio investment flows (inflow being replaced by outflow), which was associated largely with the effects of monetary policy (particularly the reduction in domestic interest rates).

The net inflow of direct investment was CZK 28.6 billion, virtually unchanged from a year earlier. The inflow of foreign direct investment (including reinvested earnings) was CZK 29.5 billion, just as in the same period of 2004. Reinvested earnings of non-residents (CZK 16.7 billion) remained the biggest contributor to foreign direct investment. The capital inflow from abroad (CZK 12.8 billion, including loans) was channelled primarily into real estate (about 80%) and industry (about 20%). A change in the structure of newly invested capital was the most significant annual change. The biggest investor was the Netherlands, followed by Luxembourg, Cyprus and the United Kingdom. Czech direct investment abroad was only CZK 0.9 billion.

The net outflow of portfolio investment was CZK 20.5 billion, contrasting with the net inflow of CZK 25.7 billion recorded in the same period of 2004. The year-on-year change in capital flows of more than CZK 45 billion was influenced mainly by residents' growing interest in purchasing foreign debt securities (probably due to the reduced attractiveness of domestic investments). Holdings of foreign bonds dropped by CZK 11.7 billion in 2004 Q1, whereas in 2005 Q1 they rose by almost CZK 25 billion. Reduced interest of non-residents in domestic koruna-denominated debt securities was also apparent. However, the net outflow of debt capital was largely offset by a government eurobond issue of around CZK 30 billion on the European market. The turnover in the flows of debt capital was probably due to the evolution of the interest rate differential of the koruna against the major world currencies – the euro and the dollar (a reduction in domestic rates, an increase in dollar rates and flat euro rates). The second important factor underlying the downturn in portfolio investment flows was a decline in non-residents' interest in holdings of domestic equity securities. Non-residents' holdings of domestic shares fell by CZK 17.1 billion in 2005 Q1, whereas in the same period of 2004 they had increased by CZK 12.1 billion. The decline in interest was apparently not caused by corporate results, but was probably due to profit-taking following the sharp increase in share prices last year. However, the behaviour of foreign investors may also have been partly associated with the evolution of the interest rate differential, which increased the exchange rate risk connected with non-residents' equity returns.

Financial derivatives transactions generated a CZK 0.5 billion rise in the financial account deficit.

Other investment recorded a net capital outflow of CZK 22.4 billion. This was almost exclusively an outflow of short-term bank capital connected with the damages paid to ČSOB and retained in Slovakia, and partly also with exchange rate hedging of the government eurobond issue on the European market. The government sector recorded a net inflow of other capital of CZK 1.8 billion (de-blocking of foreign assets in Russia). Changes in loans to the business sector had virtually no impact on the balance of payments in 2005 Q1.

The international reserves rose in 2005 Q2 as a result of the sale of the state-owned stake in Český Telecom (by about CZK 82.6 billion). Besides this one-off effect, the international reserves also reflected continuing sales of returns on reserve holdings on the foreign exchange market (about CZK 5.2 billion) and valuation changes. The international reserves in koruna terms rose by CZK 110.3 billion to CZK 746.5 billion during 2005 Q2. In dollar terms they increased by USD 2.6 billion to USD 30.1 billion.

CHART III.14

The net outflow of portfolio investment increased in 2005 Q1

(CZK billions)

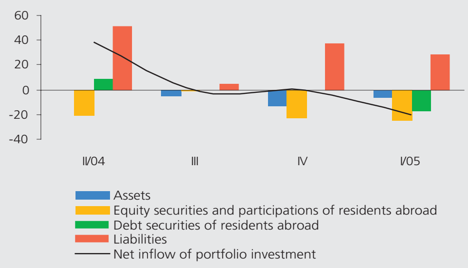


CHART III.15

The international reserves increased sharply in dollar terms in 2005 Q2

(USD billions)

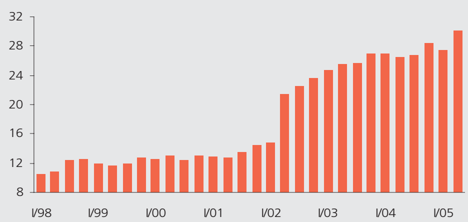


TABLE 1 (BOX)

The Czech Republic's accession to the EU significantly changed the volume and structure of its financial transactions with the EU

(CZK mil))

	2004	1 - 6/2005
Pre-accession aid	**4,877.9**	**415.2**
Phare	2,576.7	135.5
Ispa	1,086.8	0.0
Sapard	1,214.4	279.7
Agriculture	**2,813.7**	**8,603.8**
Market measures	147.3	630.7
Direct payments	0.0	6,254.7
Rural development	2,666.4	1,718.3
Structural operations	**6,082.9**	**3,576.6**
Structural Funds	5,118.5	3,222.9
Cohesion Fund	964.3	353.7
Internal policies	**387.4**	**39.5**
Transition Facility	0.0	0.0
Community programmes	387.4	39.5
Compensation	**10,466.5**	**4,494.2**
Total income from EU budget	***24,628.4***	***17,129.4***
Total payments to EU	***17,963.2***	***15,189.6***
Net position in respect of EU budget	***6,665.2***	***1,939.8***
Payments to EU institutions	**19,027.9**	**15,189.6**
Payments to EIB	879.8	0.0
Payments to ECB	184.9	0.0
Net position in respect of EU institutions	**5,600.5**	**1,939.8**

Source: Ministry of Finance; CNB calculation

BOX 3
Financial flows between the Czech Republic and the European Union

The Czech Republic's accession to the European Union in May 2004 had a profound effect on the volume and, in particular, structure of transfers vis-à-vis EU institutions. Before 2004 drawings on pre-accession aid funds were included under current government transfers and ranged between CZK 1 billion and CZK 3 billion every year. 2003 was an exception, with overall aid from the EU reaching CZK 10.5 billion, of which CZK 4 billion was received from the Solidarity Fund for flood damage repairs.

Since accession, transactions have been included either under current transfers on the current account or under capital transfers on the capital account. Under current government transfers, transfers with the EU ended in a surplus of CZK 1.5 billion in 2004. Transactions included under government capital transfers (the EU Cohesion Fund and transfers of a portion of advance payments under structural operations) recorded a surplus of CZK 5.2 billion on the capital account. The overall balance vis-à-vis the EU budget was CZK +6.7 billion in 2004 and CZK +1.9 billion in 2005 H1.

Most pre-accession aid funds were obtained through the PHARE programme, the priorities of which are institution building and investment financing. On EU accession, agricultural policy became an important transfer item, especially in the form of direct payments to farmers and the Horizontal Rural Development Plan. Payments from structural funds, realised particularly on the basis of the National Development Plan for 2004–2006, became another important source of financing from the EU. The revenue item Compensation is an outcome of the Copenhagen summit and aims at preventing any deterioration in the Czech Republic's net position following EU accession. Compensation is a direct revenue to the state budget and is not tied to the implementation of specific projects. Table 1 (Box) shows turnovers by type of transactions performed in 2004 and 2005 H1.

Other government and CNB transactions also had to be executed after EU accession. The government's payment of EIB capital and reserves and the CNB's payment of ECB capital in 2004 reduced the financial account surplus by CZK 1.1 billion.

CHART III.16
Monetary aggregate growth increased somewhat in May 2005 after slowing in Q1
(annual percentage changes)

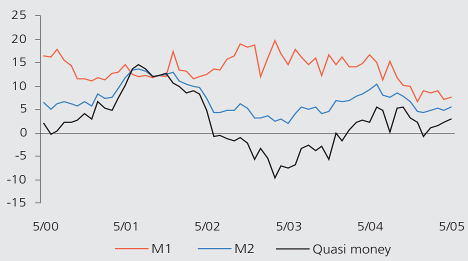


CHART III.17
Within the M2 deposit structure, the slowdown in growth of deposits of non-financial corporations halted in May
(annual percentage changes)

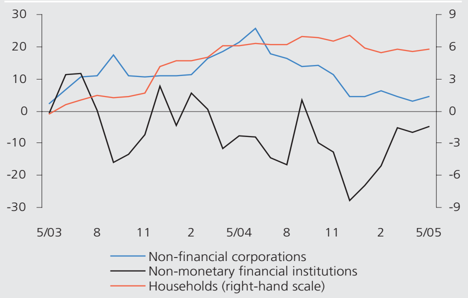
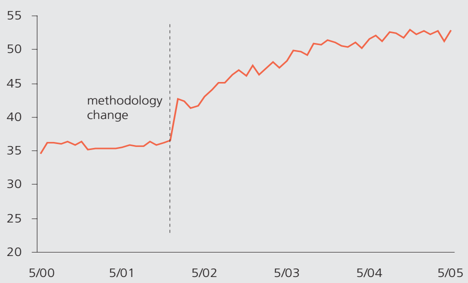


CHART III.18
The share of M1 in M2 remained at a historical high
(percentages)



III.4 MONETARY DEVELOPMENTS

The slowdown in money growth recorded since the second half of last year came to a halt in May 2005. This reflected a moderate recovery in growth in deposits by non-financial corporations. The share of M1 in M2 was relatively high, confirming that the slightly easy interest rate component of the monetary conditions remained a significant factor behind monetary developments. The favourable financing conditions also encouraged demand by non-financial corporations for credit. Long-term investment loans continued to grow. Growth in loans to households was buoyant, with housing loans predominating. Growth in consumer credit was supported by a reduction in the interest rate on consumer credit. The debt burden on households was higher than in previous years.

III.4.1 Money

M2 growth continued to slow in 2005 Q1. According to the latest available figure, the decline in growth stopped at 5.4% in May 2005 (see Chart III.16). The annual rate of growth of M2 adjusted for revaluations, exchange rate movements and other effects reached 5.9%. The lower M2 growth in 2005 Q1 was associated with a slowdown in the rate of growth of deposits by non-financial corporations (see Chart III.17). This slowdown came to a halt in May. The slightly easy interest rate component of the monetary conditions kept the share of M1 in M2 relatively high at 52.7% (see Chart III.18). Owing to the low opportunity costs of holding money, the demand of economic agents continued to focus on highly liquid money.

The rate of growth of M1 was flat in Q1 and increased slightly to 7.6% in May (see Table III.2). Overnight deposits by households grew more slowly. Conversely, annual growth in currency in circulation increased. Growth in quasi money slowed in Q1.

In May, it recorded a moderate recovery to 3%. However, it remains at a low level. Growth in deposits of non-financial corporations and households with agreed maturity was slower in Q1. The subsequent growth in these deposits in May was connected with a moderate recovery in nonmarketable securities, in which non-financial corporations invest their temporarily free funds. Deposits redeemable at notice also grew.

Annual rates of growth calculated from monthly financial transaction flows adjusted for revaluations, exchange rate movements and other effects were used to evaluate the counterparts of M2. The slowdown in M2 growth was due partly to a moderate decrease in the rate of growth of net external assets, which occurred despite the government eurobond issue in March. In addition, M2 growth was depressed by a rise in other net items (particularly capital, reserves and securities issued). The acceleration of M2 growth in May was also fostered by a further increase in the inflow of foreign funds, due – among other things – to the sale of Unipetrol. The annual rate of growth of net external assets increased from 10% in December 2004 to 14% in May 2005. M2 growth was also supported by an increase in the annual rate of growth of loans to corporations and households from 15.3% December 2004 to 17.8% in May 2005. Net credit to the government, the annual decline of which accelerated from 28.9% in December 2004 to 34.7% in May 2005, contributed to the slowdown in M2 growth in the period under review. From a long-term perspective, this decrease was due mainly to a shift in the structure of government financing towards foreign entities and the repayment of a loan granted to the Czech Consolidation Agency in connection with the sale of some receivables.

III.4.2 Credit

Credit growth accelerated further in 2005 Q1 and reached 16.4% in May 2005. An expansion was apparent for both businesses and households[12]. The growth continued to be supported by the slightly easy interest rate component of the monetary conditions.

Q1 saw an ongoing acceleration of growth in lending to non-financial corporations at all maturities, to 10.9% (see Table III.3). Corporate demand for long-term investment loans remained strong. Growth was recorded in credit to both foreign-controlled and domestic corporations, although only credit to foreign-controlled corporations increased in May. The share of new loans of greater than CZK 30 million, provided usually to large corporations, was 37.8% in May. However, it has been decreasing since mid-2004. The share of new loans of up to CZK 30 million, provided usually to small and medium-sized enterprises, was 15.3%. The share of new bank overdrafts increased further to 46.9%, indicating that the favourable interest rate conditions are encouraging businesses to finance their operating needs using external funds.

As regards the structure of liabilities of non-financial corporations with 100 employees or more, growth in both external funds and own funds accelerated in 2005 Q1. The year-on-year increase in external funds was 4.6% (compared to 2% in 2004 Q1). Own funds rose by 7.7% (as against 4.2% in 2004 Q1). However, the increase in own funds was only modest in comparison with the previous quarter, reflecting slower growth in pre-tax profit. The share of own funds in the total liabilities of corporations was 53% and the share of external funds was 47%.

12 In 2002–2004, the ratio of credit to GDP increased by 2.3 percentage points to 32.3%. Compared to Greece (71%), Spain (113%) and Portugal (160%), i.e. countries at an economic level broadly comparable to that of the Czech Republic, this ratio and its growth over that period have so far been lower. Credit growth is fast, however, and the level of financial intermediation can be expected to gradually converge to that in the countries mentioned. The ratio of credit to GDP in the euro area was 114%.

TABLE III.2

M1 growth rose somewhat in May after stagnating in Q1
(quarterly averages and end-of-month stocks; percentages)

	III/04	IV/04	I/05	4/05	5/05	Outstanding amount as % of M2 5/05
M1	12.7	8.8	8.8	7.1	7.6	52.7
Currency in circulation	7.7	6.7	7.7	8.2	8.7	13.0
Overnight deposits	14.4	9.6	9.1	6.7	7.3	39.7
M2-M1 (quasi money)	3.3	3.5	0.6	2.3	3.0	47.3
Deposits with agreed maturity	3.7	3.5	-0.1	0.9	2.1	36.4
Dep. bills of exch. and other bonds	29.1	21.6	-6.2	-12.7	2.0	6.5
Deposits redeemable at notice	-1.1	4.2	8.8	10.0	10.3	10.4
Repurchase agreements	75.7	-10.8	-37.4	-25.2	-39.4	0.5
M2	8.0	6.2	4.8	4.7	5.4	100.0

TABLE III. 3

Lending to non-financial corporations continued growing
(quarterly averages and end-of-month stocks; annual percentage changes)

	III/04	IV/04	I/05	4/05	5/05
Loans up to 1 year	0.3	2.3	2.9	4.0	4.8
Loans over 1 year and up to 5 years	12.9	17.1	14.8	17.1	18.9
Loans over 5 years	7.2	9.1	13.9	11.6	12.8
Loans to non-financial corporations, total	5.6	8.0	9.4	9.7	10.9

CHART III.19

The average interest rate on new loans to non-financial corporations fell, fostering growth in loans
(percentages)

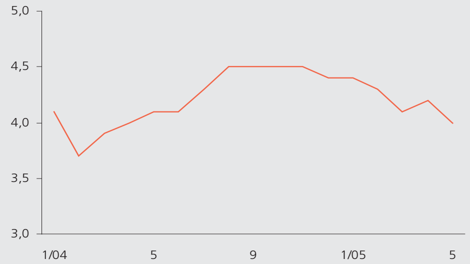


TABLE III.4

Growth of loans to households remained high
(quarterly averages and end-of-month stocks; annual percentage changes)

	III/04	IV/04	I/05	4/05	5/05
Housing loans	35.9	35.3	32.7	34.6	34.5
Consumer credit	22.4	23.9	24.9	28.7	32.3
Other loans	28.8	34.9	37.2	27.6	21.7
Loans to households, total	31.9	32.7	31.5	32.5	32.5

CHART III.20
Average interest rates on new loans to households fell, with the exception of overdraft rates
(percentages)

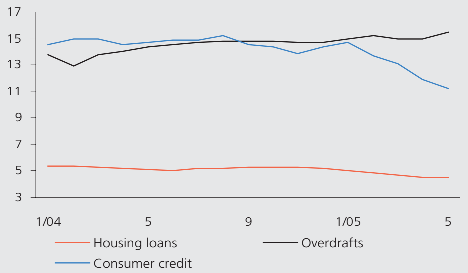


CHART III.21
The relative indicators of household indebtedness again rose slightly in 2005 Q1
(percentages)

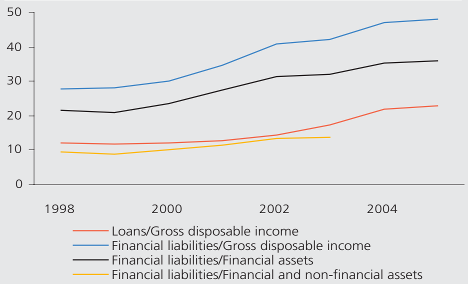


CHART III.22
The structure of household assets was stable, with non-financial assets having the largest share
(percentages)

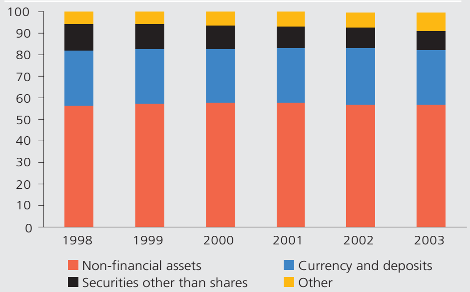
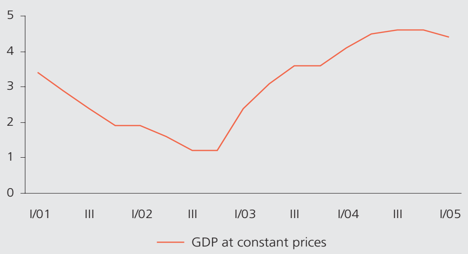


CHART III.23
The high economic growth of above 4% continued at the start of 2005
(annual percentage changes)



The financing conditions of non-financial corporations remained favourable in Q1. The average interest rate on loans to these corporations fell (see Chart III.19). However, the spread between the average interest rate on loans to non-financial corporations and the 1Y PRIBOR increased slightly to 2.2% in May, affected by the current phase of the business cycle.

As regards the structure of credit by sector, the main contributors at the beginning of this year were loans to manufacturing, loans to wholesale and retail trade, sales, maintenance and repairs, loans for renting of machinery and equipment and loans to other branches, covering mainly loans to households. These sectors were still among the main contributors to GDP formation, although the share of manufacturing declined in Q1.

Growth in loans to households remained high in Q1, owing to low interest rates and the availability of bank loans, and reached 32.5% in May (see Table III.4). Housing loans still accounted for the majority of total loans (67.4%). Consumer credit growth accelerated in May as a result of a drop in the consumer credit interest rate. The bulk of consumer credit consists of bank overdrafts, connected primarily with debit balances on current accounts. New bank overdrafts accounted for 52% of new loans to households in May. The share of other new consumer credit increased to 14.5%. The analogous share for new housing loans was 29.2% (the remaining 4.3% being other loans).

With the exception of the interest rate on bank overdrafts, average interest rates on new loans to households decreased in Q1 and in May (see Chart III.20). Their decline was similar to, or lower than, that of the financial market interest rates they are derived from (i.e. the 3M PRIBOR and 5Y IRS). However, the decline in the consumer credit interest rate was much sharper than in the case of the 3M PRIBOR interest rate. This probably reflected increased competition between monetary financial institutions and other financial institutions, with monetary financial institutions trying to reduce their costs related to consumer credit. The spread between the interest rate on consumer credit and the 3M PRIBOR reached 9.4% in May. The spread between the interest rate on bank overdrafts and the 3M PRIBOR was 13.7%. The analogous spread between housing loans and the 5Y IRS was 1.7%.

The persisting buoyant growth in loans to households resulted in a slight increase in household indebtedness. In 2005 Q1, the ratio of total credit to gross disposable income rose by 0.9 percentage point quarter on quarter to 22.7%. The ratio of financial liabilities (including credit and other liabilities arising from the time discrepancy between a transaction and the corresponding payment) to gross disposable income reached almost 50% (see Chart III.21). These indicators suggest that the debt burden on households, associated mainly with financing housing investment, is relatively high compared to previous years. It is being accompanied by growth in repayment of loan principal and lower formation of liquid financial assets. This is evidenced by an increase in the ratio of financial liabilities to financial assets to more than one-third. The ratio of financial liabilities to total assets was around 15% in 2003 (more recent data is not yet available). Despite the growth in indebtedness, the structure of household assets was little changed up to 2003 (see Chart III.22). The share of non-financial assets in total assets remained stable. It has been around 57% since 1998. The share of financial assets was 25% and that of securities and ownership interests was 9%, the same as for other assets.

III.5 DEMAND AND OUTPUT

The long period of economic growth visible since the start of 2003 continued into 2005 Q1. At 4.4%, the annual GDP growth rate was down only slightly compared to the previous quarter. According to the CNB's estimates, economic output was still below the potential output level, but the output gap was by now only slightly negative[13].

The relatively fast GDP growth of above 4% was maintained thanks primarily to real export growth, which was buoyant at the beginning of 2005 despite a slight reduction in the rate of growth. The still strong export performance of the Czech economy was fostered above all by inflow of foreign direct investment and the Czech Republic's accession to the EU, whereas the weaker economic growth in the Czech Republic's major trading partner countries (the EU-15) did not have a significant impact on exports by domestic corporations. The fast-growing exports, accompanied by much slower growth in imports, meant that net exports were the key driving force behind GDP growth for the second consecutive quarter – their contribution reached almost 4 percentage points.

As regards domestic demand, the economic growth was driven mainly by investment demand, which remained high despite slackening at the beginning of 2005. Its relatively fast growth was supported mainly by foreign direct investment, fast-growing exports and the slightly easy interest rate component of the monetary conditions. The effect of consumer demand on GDP growth declined again. As in the previous quarter, government expenditure on final consumption made no contribution to GDP growth. On the supply side of the economy, the economic growth was driven primarily by the services sector, while the contribution of industry was considerably lower than in the previous quarter.

TABLE III.5

The contribution of net exports to GDP growth in 2005 Q1 was the highest

(annual percentage changes)

	2004 Q1	2004 Q2	2004 Q3	2004 Q4	2005 Q1
Gross domestic product	4.1	4.5	4.6	4.6	4.4
Aggregate demand (domestic demand and exports)	7.4	14.9	11.5	10.3	8.5
Total domestic demand[a)]	4.6	4.2	2.8	0.3	0.7
Final consumption expenditure	1.8	1.4	0.3	-0.1	-0.2
of which:					
Household consumption	2.8	1.9	1.8	1.5	1.3
Government consumption	-0.6	-0.1	-3.4	-3.9	-3.8
Non-profit institutions serving households	8.0	8.2	14.8	15.6	6.1
Gross fixed capital formation	7.9	7.4	8.0	7.0	5.5
Imports of goods and services	11.0	27.8	19.3	15.5	12.1
Exports of goods and services	10.9	29.5	23.6	23.0	17.9
Net exports of goods and services (CZK billions)	-43.9	-59.8	-53.8	-61.2	-27.2

a) including change in inventories

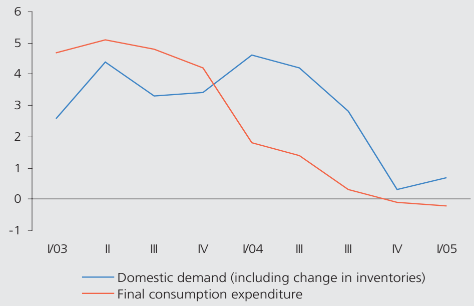
III.5.1 Domestic demand

Aggregate domestic demand growth in Q1 was modest and remained below 1%, as in the previous quarter. The low domestic demand growth was due mainly to final consumption expenditure, which fell slightly for the second consecutive quarter (by 0.2% year on year). This fall was caused above all by strongly decreasing government expenditure on final consumption, which has been on the decline for three quarters (falling by 3.8% in Q1) and was not offset by growth in household consumption. Growth in households' consumption expenditure slowed again (to 1.3%). Only investment demand recorded relatively fast growth.

CHART III.24

Annual domestic demand growth remained subdued in 2005 Q1

(annual percentage changes)



Investment demand

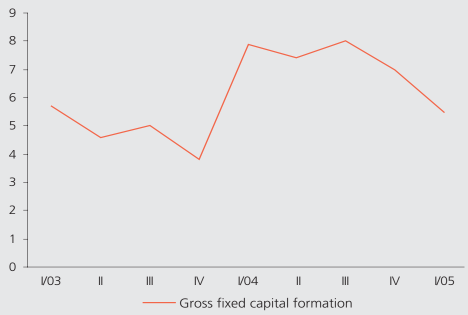
Compared to 2004, investment demand growth slowed noticeably in 2005 Q1. Nevertheless, growth in gross fixed capital formation remained fairly high (5.5% year on year) and the rate of investment[14] stayed above 25%.

The moderation in the growth rate of gross fixed capital formation at the beginning of 2005 was accompanied by a significant change in the structure of investment by kind, namely an increase in the share of investment in machinery and equipment and transport equipment in total investment to almost 70% and a fall in the share of construction investment. This structural change was associated with the developments in investment demand in all monitored sectors[15]. The reduction in construction investment and consequently total investment demand was probably due largely to the government sector, as state and municipal budget capital expenditure rose by only 3.5% at current prices in 2005 Q1 following an extraordinary increase at the end of 2004. Construction investment slowed in the

CHART III.25

Investment demand growth slackened further at the start of 2005, but remained high

(annual percentage changes)



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

14 The share of gross fixed capital formation in GDP.

15 The assessment of investment developments in individual sectors is based on partial indicators; the structure of investment is published by the CZSO in a breakdown by kind.

CHART III.26
Investment in machinery and transport equipment rose, while construction investment generally decreased
(CZK billions; constant prices)

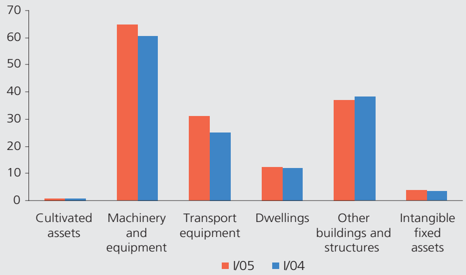


CHART III.27
Consumer demand growth continued slowing in 2005 Q1
(annual percentage changes)

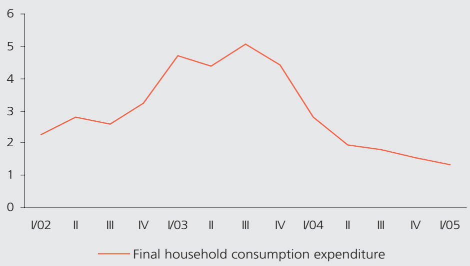
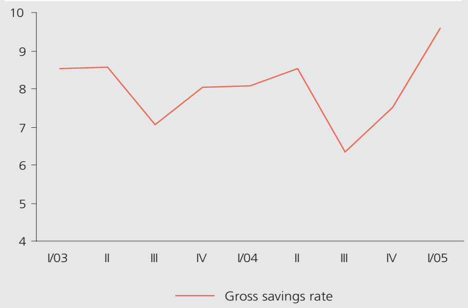


CHART III.28
The gross savings rate increased sharply year on year in 2005 Q1
(percentages)



household sector as well. However, housing investment by households again grew relatively fast in 2005 Q1 (by 5% year on year) thanks to low real interest rates on mortgage loans and ongoing rapid housing construction. Continuing growth in housing investment by households was also indicated by an increase in the number of housing completions and, as regards the future trend, a rise in the number of housing starts in Q1 (of 5.8% and 6.1% respectively).

In the non-financial corporations sector, which accounts for around two-thirds of total investment, partial indicators suggested that investment growth remained the same as in the previous quarter (at about 5%). This growth was driven solely by a rise in investment in machinery and equipment and transport equipment (of 12.4% year on year), whereas construction investment recorded an annual decline. The structure of the non-financial corporations generating the investment activity growth also shifted – besides foreign-controlled corporations, domestic private enterprises, whose investment had still been declining in the previous quarter, made a significant contribution[16].

Consumer demand

Consumer demand growth continued to slacken in 2005 Q1. This trend, visible since 2003 Q3 according to the CZSO's revised data, culminated in relatively low annual real growth of 1.3% in 2005 Q1. By contrast with previous quarters, when the weakening household consumer demand was mainly a result of a slowdown in real disposable income growth, the most important factor in 2005 Q1 was households' increased propensity to save.

The rate of growth of households' gross nominal disposable income in 2005 Q1 was on the same level as in the past four quarters, i.e. around 4%. The largest component, wages and salaries, contributed most to this growth in Q1, with an increase of 5.1% (CZK 10.5 billion). Wage growth eased compared to the previous quarter, but this was offset by faster growth in social benefits[17] of 6.6%. The increase in expenditure on social benefits was largely related to the indexation of retirement pensions effective from 1 January 2005, which led to an annual rise in the volume of pension payments in Q1 of 7.6% (CZK 4.4 billion). Conversely, gross operating surplus and mixed income grew only modestly (by 0.1%).

Gross nominal disposable income grew by 4% in Q1 and its real year-on-year growth reached 2.8%, but consumption expenditure increased by only 1.3% in real terms. Households thus put aside more of their income in Q1 than in the same period of last year, which resulted in a significant rise in the savings rate (of 1.5 percentage point to 9.6%). Households financed part of their consumption expenditure by borrowing. The rate of growth of consumer credit obtained from monetary financial institutions increased (for details see section III.4 *Monetary developments*). This source of funds, however, did not offset the "fall" in funds put aside as savings.

Government demand

According to the CZSO's estimate, general government expenditure on final consumption declined by 3.8% year on year in 2005 Q1. The rate of decline did

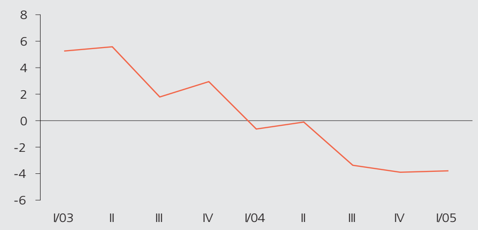
16 Newly acquired fixed assets increased by 7.8% in 2005 Q1 in foreign-controlled corporations and by 7.1% in domestic private enterprises; only fixed investment by public undertakings continued to decline year on year.

17 i.e. social benefits other than social transfers in kind.

not deviate significantly from the figures recorded in the previous two quarters (see Chart III.29).

The assessment of government demand is based on an analysis of data on the state budget performance, which cover a substantial part of the developments in the government sector as a whole. The revenue side of the state budget was affected to a significant extent by an extraordinary transfer of unused funds from the 2004 reserve funds, compensation payments from the EU budget and inflow of other EU funds for projects administered by the Ministry of Labour and Social Affairs and the Ministry of Agriculture (an increase of CZK 17 billion year on year). By contrast, tax revenues dropped annually (by 0.5%) and the developments in individual tax items were mixed, primarily as a result of an amendment to the Act on Budgetary Allocation of Taxes[18]. On the expenditure side of the state budget, the trend of strong annual growth in the wages of public employees continued (10.4%), whereas a decline in other current expenditure (of 8.3%) had a dampening effect on demand. The change in the allocation of tax revenues resulted in a considerable decrease in transfers of funds to regional budgets, but this expenditure item does not directly influence government demand. Overall, the state budget ended in a surplus of CZK 8.3 billion in 2005 Q1, which was a significant year-on-year improvement, as a deficit of CZK 7.8 billion had been recorded in 2004 Q1. To sum up, the government sector did not contribute to the increase in demand in 2005 Q1. The results of the state budget in 2005 H1 (a surplus of CZK 3.8 billion) indicate that the government sector again made no contribution to the demand growth in the economy in Q2.

CHART III.29
Government final consumption expenditure again fell year on year at the start of 2005
(percentages)



III.5.2 Net external demand

The annual improvement in net exports of goods and services[19] apparent since the second half of 2004 continued into 2005 Q1. Negative net exports decreased by CZK 16.7 billion (to CZK -27.2 billion), and their contribution to GDP growth was strongly positive, as in the previous quarter. The favourable trend in negative net exports continued owing to much higher annual growth in exports (17.9%) than imports (12.1%). Although annual growth in exports decreased in Q1 compared to the previous quarter, growth in imports was also more moderate (Chart III.31). The lead of export growth over import growth thus narrowed only slightly.

In 2005 Q1, the year-on-year improvement in net exports was primarily due to a continuing favourable trade balance, which improved by CZK 19.1 billion year on year, with the deficit changing to a surplus. In comparison to the previous year, the services deficit decreased slightly (by CZK 1.5 billion). The fall in the net export deficit thus reflected a high export performance of the Czech economy, as a large increase in goods exports (19.5% year on year) was achieved amid overall weaker economic growth in the Czech Republic's major trading partners (the EU-15). The shift of production from advanced market economies to the Czech Republic, as well as EU accession, also had a positive effect. The slower growth rate of goods imports (13.5%), which also helped improve net exports, was primarily due to slower growth in all the main components of domestic demand. This affected all import categories as regards use, with the steepest decline in growth rate being recorded for imports for investment.

CHART III.30
Net exports recorded a year-on-year improvement in 2005 Q1
(CZK billions; constant prices)

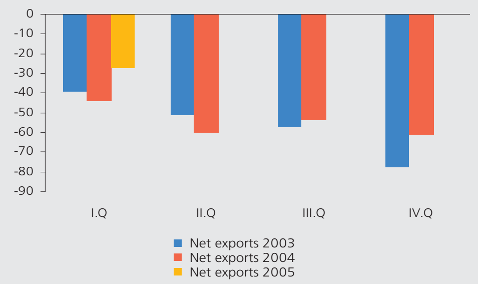


CHART III.31
Exports rose faster than imports for the fourth consecutive quarter
(annual percentage changes; constant prices)

18 Effective from January, the rates determining the allocation of shared tax revenues between the state budget, the regional budgets and the State Transport Infrastructure Fund were changed. Therefore, tax revenues are not directly comparable from the methodological point of view. According to revised data taking these changes into account, revenues from VAT and natural person income tax were flat, whereas revenues from excise duties and legal entity income tax recorded a significant annual rise.

19 At constant 1995 prices.

CHART III.32

The services sector was the biggest contributor to the GDP growth recorded in 2005 Q1

(contributions in percentage points, selected branches)

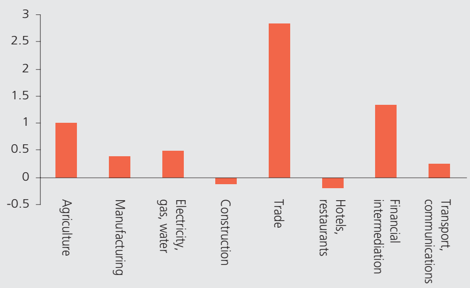


CHART III.33

The slowdown in industrial production growth was due to a combination of several factors

(annual percentage changes; constant prices)

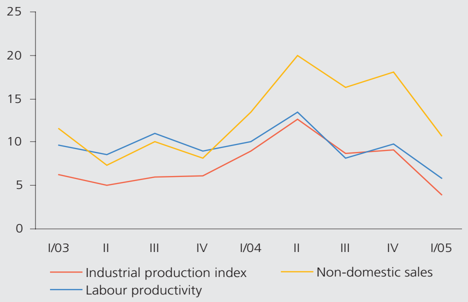
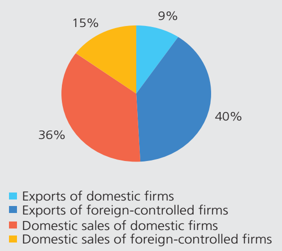


CHART III.34

Exports were due predominantly to foreign-controlled firms

(2005 Q1;shares in total industrial sales - domestic and external - at constant prices)



III.5.3 Output

On the supply side, the GDP growth of 4.4% in 2005 Q1 was chiefly due to the services sector. Gross value added growth was, however, very mixed here. Chart III.32 shows that the largest contribution was recorded by trade. A further increase in the share of trade in GDP growth was accompanied by ongoing structural changes in this segment, resulting in a rise in the number of large sales outlets (supermarkets etc.) in the total number of sales outlets.[20] A relatively large increase in gross value added was also recorded for financial intermediation and insurance. The annual growth in gross value added in transport and communications was mostly attributable to telecommunications services. In contrast, the 2004 H2 fall in gross value added continued in hotels and restaurants. This was most probably result of reduced demand after the VAT rate hike in restaurants in May 2004.

Unlike in services, annual growth in gross value added in industry recorded a marked slowdown in 2005 Q1 (to 2.1%) and its contribution to GDP growth thus decreased significantly compared to a quarter earlier.[21] Slower creation of gross value added in industry was indicated by the index of industrial production and sales from industrial activity in Q1. The lower growth rate of industrial production, amounting to 4% in Q1, was primarily due to lower economic activity in EU countries, weaker growth on the iron and steel market, a decline in production and sales in the textile and clothing industry, some companies' preparations for the switch to new production activities, and to base effects (2004 Q1 was one working day longer).

Although growth in exports slowed owing to the lower external demand, it remained the fastest growing item of sales of industrial corporations. Exports accounted for almost one half of total sales in industry (49.3%). Total sales from industrial activities increased by 6%, while sales from direct exports grew by 10.7%. As in previous quarters, exports were largely realised by foreign-controlled corporations. Rapid growth was recorded, for example, for exports of machinery and equipment, transport equipment, and food products.[22] Growth in the manufacture of coke and refined petroleum products was also very fast (12.5%). Production in individual sectors suggested continuing structural changes in industry, related to changing demand for their products and their market position in a strongly competitive environment. Besides the quickly developing sectors, some sectors have seen a decline in production – in particular, the textile industry (owing to cheaper Asian competition) and the leather industry.

Gross value added in construction has been falling short of the level of the same period a year earlier for several quarters. Its annual decline of 3.7% in Q1 was primarily due to weaker investment activity in construction output (see the section *Investment demand*). In contrast, agriculture showed a continuing rapid increase in gross value added (up by 32.1% on a year earlier).

20 The building of large sales outlets generates economies of scale and improves their position in respect of suppliers.

21 Industry accounted for about one third of total GDP at basic prices.

22 The annual growth rate of exports in these sectors was between 17% and 22%.

III.5.4 Financial performance of non-financial corporations[23]

The financial results of large non-financial corporations in 2005 Q1 signalled a halt in the previous two years' favourable tendencies, namely high growth in profit generation accompanied by increasing profitability. Compared to the previous quarters, large non-financial corporations, accounting for about one half of this sector's output, saw a considerably slower increase in value added at current prices, to 2.7% (11.2% in 2004 as a whole). The increase in pre-tax profit moderated even more markedly, growing by mere 0.6% year on year. Operating surplus actually declined year on year, amid faster growth in cost of sales than output[24], suggesting that the profit growth was attributable to sideline activities.

The marked slowdown in profit generation in the sector of large financial corporations was due to a combination of several factors. Weaker domestic demand and, to a lesser extent, external demand caused slower growth in output and productivity. At the same time, prices of imported raw material inputs continued to grow, which implied continuing fast growth in producer prices (exceeding 20%) in domestic primary oil and metal-processing industries in Q1. At the beginning of 2005, corporate electricity costs also increased. On the other hand, although prices of a number of other imported higher value added inputs decreased year on year, the material cost-output ratio increased overall. At the same time, it was depressed by falling wage costs to a lesser extent than in the previous year. The gradual weakening of the annual growth of the terms of trade in Q1 meant that corporations had less leeway to offset the rising prices of imported inputs through export prices. The list of factors affecting the financial results of non-financial corporations at the beginning of 2005 also includes strong competition on the domestic market, which, given slower domestic demand growth, greatly limited final producers' scope for raising prices on the consumer market.

The developments described above had significant structural aspects. In Q1, profits of national private corporations and foreign-controlled corporations saw annual declines of 4% and 10% respectively. Only public non-financial corporations generated more than double the profit than in the same period a year earlier. Most of the monitored sectors recorded year-on-year falls in profits. Only about one third of the sectors generated higher profits in 2005 Q1 than in the previous year. Significantly higher profits were generated mainly in sectors at the beginning of the production chain, where demand – and probably also market position – allowed the increased costs to be passed through to production prices. Higher profits were thus recorded especially in the manufacture of basic metals and fabricated metal products, electricity and gas, and mining and quarrying. In contrast, profits decreased year on year in manufacturing, especially in the manufacture of transport equipment and in the manufacture of electrical and optical equipment, where producer prices fell year on year. Transport also recorded a decrease in profits.

Detailed structural analyses of profit factors revealed that the weak profit growth in Q1 was achieved amid a relatively significant increase in equity capital (of 7.7%), while the profit-equity rate declined year on year (by 6.6%). However, these profit indicators were mixed within the individual sectors; industry as a whole did not record a decrease in profitability. The decrease in profitability in the monitored corporations as a whole was mainly due to a decrease in the annual profit-sales ratio of 7.6%, as costs grew faster than output owing to faster growth in cost of sales (due to growth in prices in raw materials processing). Given this situation, the

TABLE III.6
Annual growth in profit generation fell sharply at the start of 2005
(annual percentage changes)

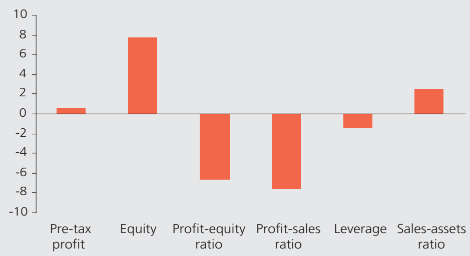
	2005 Q1	
	Organisations, total	Industry
Income, total	9.7	10.4
Output, total	8.4	9.6
Expenses, total	10.3	10.5
of which: cost of sales	11.0	12.1
personnel costs [a]	5.5	4.9
depreciation	2.5	2.5
Book value added	2.7	3.2
Pre-tax profit	0.6	10.2
Net operating surplus	-0.3	1.8

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

TABLE III.7
A higher material cost-output ratio was only partly offset by a falling personnel cost-output ratio
(percentages; percentage points; CZK thousands)

	2005 Q1 in per cent		Change in perc. points against 2004 Q1	
	Organisations, total	Industry	Organisations, total	Industry
Profit-expenses ratio	6.00	8.40	-0.50	0.00
Profit-equity ratio	3.20	4.40	-0.20	0.00
Profit-sales ratio	6.20	8.60	-0.40	-0.10
Asset turnover	27.45	27.38	0.68	2.56
Material cost-output ratio	70.40	74.82	1.68	1.05
Personnel cost-output ratio	14.35	10.96	-0.40	-0.60
Ratio of wage costs to value added	48.45	41.01	1.26	0.67
	CZK thousands per month		annual percentage changes	
Book value added per employee	51.84	60.73	1.80	2.2

CHART III.35
The profit-equity ratio decreased as a result of slower profit generation in 2005 Q1
(annual percentage changes)



23 Assessment based on figures for non-financial corporations with 100 employees or more, all industries.
24 Output excluding business margins.

profit-expenses ratio decreased. A slight annual pick-up in asset turnover (of 2.5%) affected the overall results of corporations only partially. The number of loss-making corporations increased again after several years, accounting for around 37% of all monitored non-financial corporations in Q1. The volume of wages owed by corporations increased slightly.

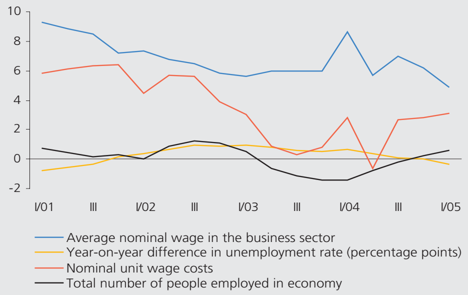
A slight deterioration of the previously favourable tendencies in financial performance was also seen in medium-sized corporations with 20–99 employees. Although employment in such corporations rose modestly and wages showed an increase of 5.2% in Q1, value added decreased by 0.3% year on year.

III.6 THE LABOUR MARKET

CHART III.36

The imbalance between the demand for, and supply of, labour continued to ease slowly

(annual percentage changes and percentage point changes)

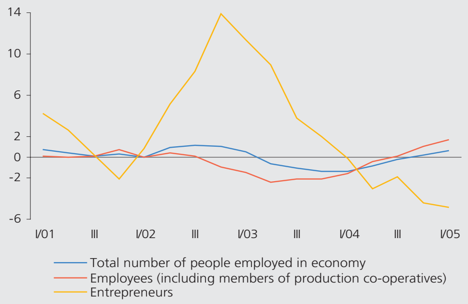


The developments on the labour market in 2005 H1 were consistent with the phase of fast economic growth and the inflow of foreign direct investment. The effect of GDP growth and FDI inflows generated a recovery in the employment rate and a slight decrease in unemployment. A more pronounced strengthening of these positive changes on the labour market was prevented by persisting structural unemployment, indicated, above all, by the high long-term unemployment rate. The slight rise in corporations' demand for labour has not affected the overall wage trend yet. On the contrary, the annual growth rate of average nominal wages decreased owing to the wage growth in the business sector declining to the lowest level since the establishment of the Czech Republic. However, the non-business sector saw a significant annual increase in wages. Annual growth in nominal unit wage costs picked up slightly at the macroeconomic level, but productivity in industry rose at a higher rate than average real wages, and nominal unit wage costs fell year on year.

CHART III.37

The number of employees in the national economy continued to rise in 2005 Q1

(annual percentage changes)



III.6.1 Employment and unemployment

The main employment and unemployment indicators at the beginning of 2005 confirmed a continuation of the favourable tendencies observed throughout 2004. Particularly significant was the continuing recovery in the employment rate, which started in 2004 Q4 and was apparent in the secondary and tertiary sectors of the economy. Annual growth in the total number of employed persons increased slightly in Q1, reaching 0.6%. As in 2004 Q3 and Q4, employment increased only in the employees category[25] in 2005 Q1 (by 1.7% year on year), while the number of entrepreneurs gradually decreased[26]. As mentioned in the previous Inflation Report, the deepening decline in the number of entrepreneurs was probably due not only to the changes to the tax laws in 2004, but also to an improving supply of steady employment opportunities. The easing labour market conditions were also evidenced by a further increase in the number of vacancies registered by labour offices (of almost 12,000 year on year in June). Under these circumstances, the average number of job applicants per vacancy (8.6 applicants) was the lowest in three years.

TABLE III.8

Labour demand increased in the secondary and tertiary sectors

(annual percentage changes; source: LFS – including members of production co-operatives)

	2004 Q1	2004 Q2	2004 Q3	2004 Q4	2005 Q1
Agriculture	-10.4	0.4	0.5	-6.0	-3.7
Industry, total	-1.5	-0.8	-0.3	0.4	0.3
of which:					
Manufacturing	-2.5	-1.8	-0.9	0.6	0.9
Construction	-7.4	-2.7	1.7	4.8	10.4
Services	0.1	1.0	0.9	2.5	1.8

The main factor underlying the recovery in labour demand was the relatively fast growth of the Czech economy. At the same time, continuing relatively high growth in employment in foreign-controlled corporations suggested that the recovery in

25 Including members of production co-operatives. In 2005 Q1, employees accounted for 84% of the total number of employed persons.

26 In 2005 Q1, the number of entrepreneurs declined by 34,000 year on year, while the number of employees increased by 66,000.

labour demand was still closely linked with inflow of foreign direct investment. Its effect was particularly noticeable in manufacturing, where employment has been increasing since 2004 Q4 (to 0.9%). At the beginning of 2005, the largest increases in the number of employed persons were, however, recorded in construction, education and health care[27]. The increase in employment in the secondary and tertiary sectors was not across the board in nature, with some sectors showing a decrease in the number of employed persons. This was primarily due to changes in the demand for individual products, ongoing structural changes in the economy and strong competition exerting downward pressure on costs.

The gradual increase in labour demand fostered a gradual decrease in unemployment. At the end of June 2005, the number of unemployed persons was down by almost 28,000 from a year earlier. The same trend was recorded for the seasonally adjusted registered employment rate. At the end of June 2005, the registered unemployment rate was 0.6 percentage point lower than in June 2004, amounting to 9.3%. Under the new methodology[28] it was lower, at 8.6%.

As in previous quarters, a larger decrease in unemployment was prevented by high structural unemployment, reflecting skills and regional gaps between the supply of, and demand for, labour. This problem was mainly indicated by the long-term unemployment rate (more than one year), which rose to a record high in 2005 Q1 (54.7% according to the Labour Force Survey). The predominant share of persons with basic and lower education in the structure of the long-term unemployed (75%) indicated at the same time that the problem of long-term unemployment was primarily related to insufficient adjustment of employees to the skills required by corporations.

III.6.2 Wages and productivity

Annual growth in average nominal wages eased further at the beginning of 2005, to 5.8%. This was the result of the wage trend in the business sector, where, compared to 2004 Q4, annual average nominal wage growth slowed to the lowest level since the establishment of the Czech Republic (4.9%). On the other hand, average nominal wage growth in the non-business sector picked up to almost double the level of the business sector in Q1, which also implied significant annual real average wage growth of slightly over 7%. However, average real wage growth rose slightly in the business sector, too. This was due to a more pronounced decrease in annual inflation. Overall, annual average real wage growth was 1 percentage point higher in 2005 Q1 than in the previous quarter, although it slowed in nominal terms (see Table III.9).

Wages in the business sector were primarily affected by the strongly competitive environment, which curbed possible price growth. At the same time, companies had to cope with some profit-reducing effects, which are specified in detail in section III.5.4 *Financial performance of non-financial corporations*. The slowdown in wage growth was also probably due in part to delays in signing collective pay agreements in some companies at the beginning of 2005 (e.g. Czech Railways and Škoda Auto). The fast growth in average wages in the non-business sector was due to pay increases for some public sector professions (the police, the prison service, fire brigades and the customs administration).

27 In 2005 Q1, the largest year-on-year rises in employment were recorded in education (13,300) and health and social care (11,200). On the other hand, year-on-year decreases were recorded for real estate, renting, trade and transport.

28 The methodological definition of this indicator was published in the October 2004 Inflation Report.

Chart III.38

According to the Beveridge curve, the rise in vacancies was accompanied by a fall in the number of people unemployed

(seasonally adjusted numbers in thousands)

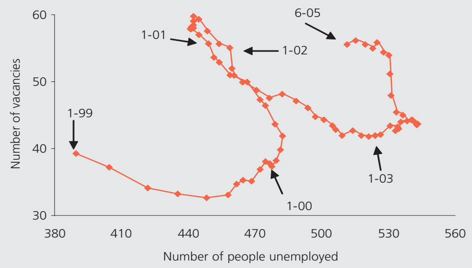


Chart III.39

A greater fall in unemployment continued to be prevented by structural unemployment

(source: LFS)

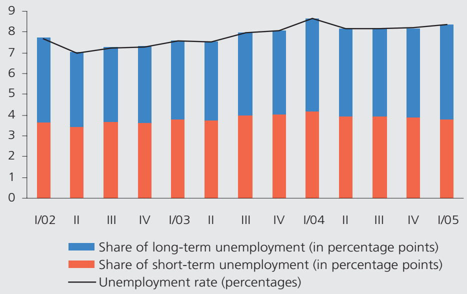


Table III.9

Average nominal wage growth slowed in 2005 Q1

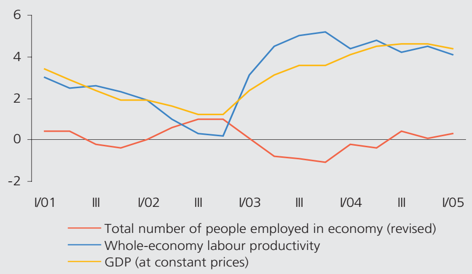
(annual percentage changes)

	2004 Q1	2004 Q2	2004 Q3	2004 Q4	2004	2005 Q1
Average wage in monitored organisations						
nominal	8.8	4.2	7.3	6.3	6.6	5.8
real	6.4	1.6	4.0	3.1	3.7	4.1
Average wage in business sector						
nominal	8.6	5.7	7.0	6.2	6.9	4.9
real	6.2	3.0	3.7	3.0	4.0	3.2
Average wage in non-business sector						
nominal	9.6	-0.5	8.3	6.4	5.7	8.9
real	7.1	-3.0	4.9	3.2	2.8	7.2
Whole-economy labour productivity	4.4	4.8	4.2	4.5	4.5	4.1
Nominal unit wage costs	2.8	-0.6	-1.3	2.8	0.9	3.1

Chart III.40

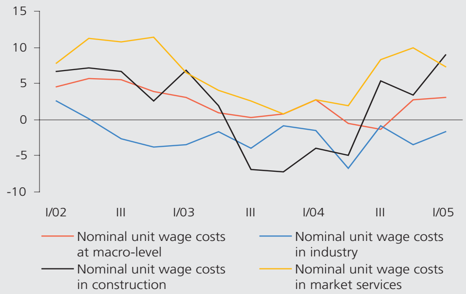
Whole-economy labour productivity growth stayed above 4%

(annual percentage changes)



Given the slight fall in GDP growth and the slight increase in employment, whole-economy labour productivity growth slowed at the beginning of 2005, but remained above 4%. This was mostly attributable to the corporate sector in industry, where productivity recorded the fastest growth (5.5%)[29]. Compared to 2004, when annual productivity growth in industry had been around 10%, the growth was much slower (see Chart III.33).

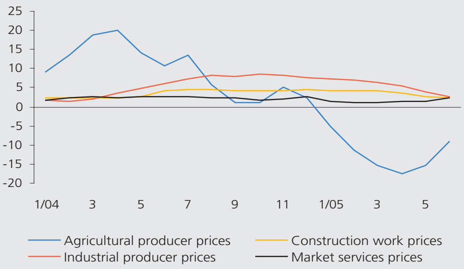
Chart III.41
Annual growth in nominal unit wage costs at the macro-level rose slightly in 2005 Q1
(annual percentage changes; selected branches)



The interaction of wage and productivity variables did not indicate significant changes in the personnel cost-output ratio in 2005 Q1 compared to the previous quarter. Growth in nominal unit wage costs, which are also an indicator of potential inflationary pressures in this area, accelerated by 0.3 percentage points to 3.1% in Q1. The causes of the year-on-year growth in nominal unit wage costs must still be sought primarily in the non-business sector, where average nominal wages rose significantly. Industry, which has to cope more with foreign competition, continued to show faster growth in productivity than average wages, with nominal unit wage costs declining year on year (by 1.7%). Thus, wage growth in industry was not a source of inflationary cost pressures at the start of 2005. The sizeable annual growth in nominal unit wage costs in construction was due to base effects, as most companies had invoiced for their output to a larger extent in 2004 prior to the introduction of the higher VAT rate.

III.7 IMPORT PRICES AND PRODUCER PRICES

Chart III.42
Industrial producer price inflation and construction work price inflation moderated in 2005 Q2
(annual percentage changes)



Import prices and industrial producer prices in 2005 Q2 indicated a continuing fall in cost-push inflationary pressures. Import prices continued to fall year on year. This was largely due to year-on-year appreciation of the exchange rate of the koruna, which considerably alleviated the impacts of external prices on import prices. This factor fostered a year-on-year fall in prices of imported higher-value-added products and clearly slower growth in prices of imports of raw materials than in world markets. The mostly falling import prices and also slower growing prices of imported metals created conditions for a further slowdown in industrial producer price inflation, which rose much more slowly than in the previous quarter. Producer prices of products with a higher degree of processing continued to decrease for the most part in year-on-year terms. Only energy price inflation (electricity, coal) picked up further. Agricultural producer prices continued to show a significant year-on-year fall, owing to the above-average harvest in 2004 and other factors.

III.7.1 Import prices

Table III.10
Import prices again fell year on year in the first two months of 2005 Q2
(annual percentage changes)

	12/04	1/05	2/05	3/05	4/05	5/05
Imports, total	0.1	-0.4	-1.1	-1.9	-0,5	-0.3
Food and live animals	-1.2	-0.1	-0.5	-0.9	-1.6	-0.6
Beverages and tobacco	4.3	4.3	2.3	1.6	3.1	1.6
Crude materials except fuels	3.4	3.3	3.3	2.2	3.2	0.7
Mineral fuels and related products	14.1	18.0	19.3	18.6	25.7	18.4
Animal and vegetable oils	0.6	-3.3	-5.7	-7.9	-9.3	-10.0
Chemicals and related products	0.6	-1.0	-2.2	-2.8	-1.8	-0.3
Manufactured goods classified by material	2.5	1.4	0.5	-0.6	-0.3	0.3
Machinery and transport equipment	-4.2	-5.3	-5.7	-6.4	-5.5	-4.3
Miscellaneous manufactured articles	-2.6	-4.4	-6.0	-7.6	-7.5	-6.7

Given the high openness and import intensity of the Czech economy, import prices are an important domestic inflation factor. According to the latest CZSO figures, import prices again declined year on year in the first two months of 2005 Q2. However, the gradual deepening of their annual decline witnessed in Q1 did not continue. On the contrary, the price decline moderated (to 0.3% in May).

As in 2005 Q1, the fall in prices was largely due to import prices in higher-value-added product categories, especially machinery and transport equipment and miscellaneous manufactured articles. The annual decline in import prices in these categories reached relatively high figures, largely reflecting decreasing prices of these commodities in the Czech Republic's major trading partner countries and the continuing significant annual appreciation of the koruna's exchange rate. The

29 Calculated from sales at constant prices.

decline in import prices was also partly attributable to chemicals and related products, food and vegetable oils, whose prices had been increasing throughout 2004.

Nevertheless, import prices of raw materials continued to grow, as annual growth in raw materials and food prices on world markets[30] remained high in 2005 Q2, reaching 39.7% on average. These high figures were attributable to energy-producing materials, whose annual price growth picked up further, exceeding 50% in April and June[31]. In contrast, growth in world metal prices showed a further slowdown in Q2, reaching one-half to one-third of the values recorded in 2004 (12.5% year on year in June). World prices of other raw materials and food imported to the Czech Republic were mixed, with commodities with falling prices prevailing overall.

The impacts of world prices on domestic prices were again largely corrected by the koruna's exchange rate in 2005 Q2. In the case of oil and natural gas, the impact of the high annual growth in world prices on import prices was offset by year-on-year appreciation of the koruna-dollar exchange rate, which amounted to 10% in Q2[32]. Despite this, annual growth in import prices of energy-producing materials was quite high, reaching 18.4% according to the latest figures for May. Import prices of non-energy-producing materials rose much more slowly (0.7% in May) than prices of energy-producing materials, owing to slower growth in world prices of metals and the annual appreciation of the koruna-dollar exchange rate. Compared to the previous year, their positive contribution to the overall annual change in import prices was therefore almost negligible.

Important from the point of view of domestic inflation was the predominance of import categories with falling prices and the modest growth in prices of non-energy-producing materials in the first two months of 2005 Q2. Faster growth in import prices was thus recorded only for mineral fuels.

III.7.2 Producer prices

Industrial producer prices

The continuing downward trend in annual industrial producer price inflation in 2005 Q2 (to 2.7% in June) was largely linked with the weakening external cost pressures. Considerably lower prices of some domestic inputs (particularly crop products) also fostered a sizeable slowdown in producer price inflation in Q2.

This slowdown in industrial producer price inflation (PPI) was largely due to prices in primary metal processing, which responded to the rapid slowdown in the growth of world metal prices and subsequently import prices with a relatively short lag. In 2005 Q2, the annual growth in prices of producers of basic metals and fabricated metal products declined by 18.5 percentage points to 5.7% compared to the end of the previous quarter. As a result of this considerable change, their contribution to the PPI growth fell in June to roughly one-quarter by comparison with March (see Chart III.46).

30 Measured by the CZSO's annual world price index.

31 Annual growth in the Brent crude oil price picked up from 35.8% in December 2004 to 56.2% in June, while prices of natural gas rose from 26.2% to 47.4% in the same period.

32 The koruna-dollar exchange rate appreciated by 10.9% year on year in 2004 Q4 and by 12.8% and 10% in 2005 Q1 and Q2 respectively. The annual appreciation of the koruna-euro exchange rate was lower, showing the following values over the same period: 2.9%, 8.6% and 5.9%.

CHART III.43

Most of the import categories contributed to the modest decrease in the import price index

(annual percentage changes; contributions in percentage points)

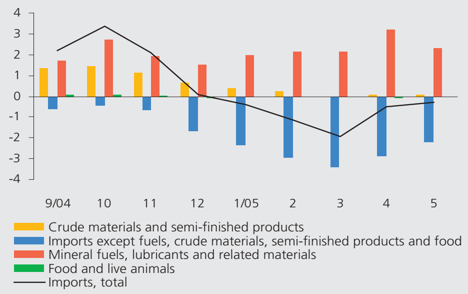


CHART III.44

The impacts of the fast-rising world prices of raw materials on import prices continued to be corrected by the koruna-dollar exchange rate

(annual percentage changes)

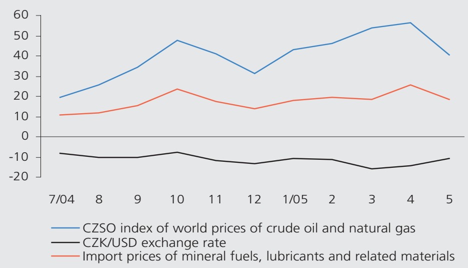


CHART III.45

The downward trend in industrial producer price inflation continued into 2005 Q2

(annual percentage changes)

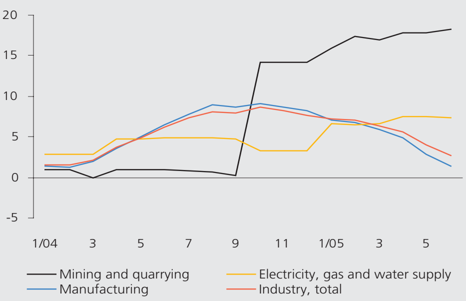
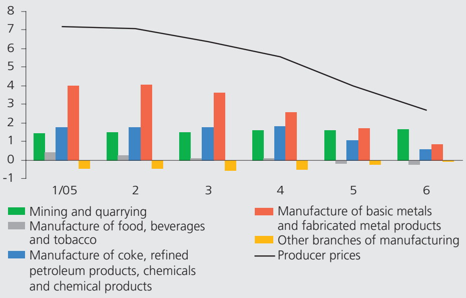


CHART III.46
The metal-processing industry was the biggest contributor to the slowdown in industrial producer price inflation
(annual percentage changes; contributions in percentage points)



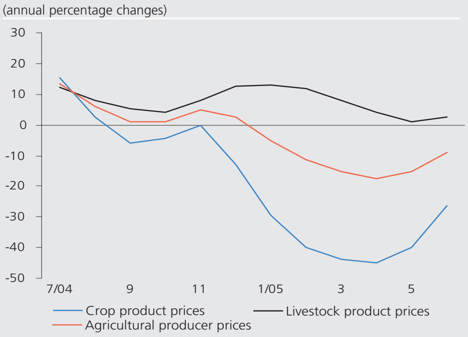
The lower industrial producer price inflation in 2005 Q2 was also due to sectors involved in primary processing of oil, even though import prices of energy-producing materials increased in 2005 H1. In this case, the producer price inflation rate seemed to be corrected to the level of import price inflation, as producer prices in the manufacture of coke and refined petroleum products at the beginning of 2005 grew at roughly the same rate as oil prices on world markets. In Q2, their annual growth eased considerably (to 9.7% in June). Growth in producer prices in the related chemical industry also slowed significantly (to 2.1%). Due to an extraordinarily large annual decline in crop prices of domestic primary producers, inflation in the food industry also gradually decreased, turning to a slight year-on-year decline in May (-1.1% in June; see *Agricultural producer prices*). Other manufacturing sectors[33] recorded a continuing year-on-year decline in prices[34], although this eased by comparison with the end of Q1 (to 0.1%).

Only non-manufacturing industries saw a further acceleration of their already sharp inflation in Q2. Producer prices grew year on year in the electricity, gas and water supply industry, owing to growth in prices of electricity for the corporate sector to 7.4% in June. Even more pronounced inflation was recorded in mining and quarrying, owing to a rise in coal prices (18.2% in June). These sectors thus accounted for roughly half the annual inflation in industry in Q2 (see Chart III.46).

Although overall producer price inflation eased considerably in 2005 Q2, it remained very mixed in structure. Faster price growth was concentrated in a few sectors with a relatively high share of input raw materials in the price of the final product (in particular sectors at the beginning of the product vertical) and in sectors linked to the production of energy. Conversely, sectors with a higher share of sophisticated products, lying at the end of the product vertical, showed continuing slight growth or an annual decline in prices. The very weak or zero transmission of the rapidly rising prices of some key inputs into producer prices at the end of the product vertical was due to a number of factors on the demand and supply side specified in detail in the previous Inflation Report[35].

Agricultural producer prices

CHART III.47
The sharp decline in agricultural producer prices was linked with movements in crop product prices
(annual percentage changes)



Agricultural producer prices recorded another large year-on-year fall in 2005 Q2 (-9.2% in June). This was primarily due to crop products, prices of which showed a much stronger year-on-year decline between December 2004 and April 2005 to their lowest level since 1992 (-44.8% in April). According to the latest figures for June, their annual decline eased to 26.4%.

The main reason behind this extraordinary development was the good harvest in 2004 (particularly for cereals[36]), which changed the supply-demand relationship in the agricultural commodity market. 2005 Q2 again saw no elimination of the surplus from the market which would, before the coming harvest, boost the record low domestic prices, which for cereals are around 15% below the EU intervention price. No less important for domestic inflation was the pronounced year-on-year appreciation of the koruna-euro exchange rate since November 2004, which

33 Manufacturing excluding manufacture of coke and refined petroleum products, chemicals, chemical products and man-made fibres, and basic metals and fabricated metal products.

34 Chiefly prices of producers with more sophisticated production.

35 See the box *The transmission of external cost shocks into domestic prices in 2003–2005* in the April 2005 Inflation Report.

36 The annual decline in prices of cereals was 35.9% in May.

reduced the level of EU intervention prices and at the same time made food imports to the domestic market cheaper. This factor seems to have fostered a considerable decline in prices of other items, in particular vegetables and potatoes[37]. As mentioned in the previous Inflation Report, the rapidly deepening annual price decline in crop production in 2005 H1 was also partly due to a different price index structure, which has been changing from month to month.

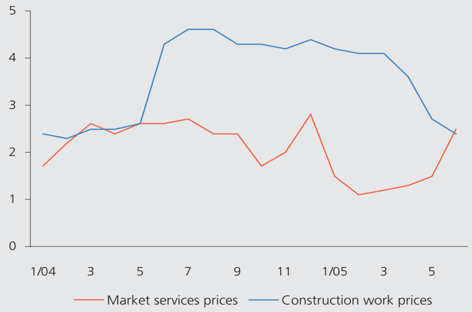
Prices of the higher-weight livestock products in 2005 Q2 reflected the unwinding of the one-off effect of the Czech Republic's accession to the EU, when opportunities to export livestock products to EU countries at better prices improved sharply. The previous relatively fast growth of livestock product prices was thus replaced by a rapid decline in price growth to 2.4% in June.

Other producer prices

Construction work price inflation recorded a marked slowdown in 2005 Q2 compared to previous quarters. Annual construction work price inflation had been around 4% in 2005 Q1, whereas in Q2 it dropped below 3% (2.4% in June). This change was probably linked with considerably slower growth in prices of materials and products consumed in the construction industry (to 4%), related, in turn, to a moderation in price growth of imported metals used in the construction industry.

On the other hand, annual price inflation of market services for the business sector picked up noticeably in 2005 Q2 (to 2.5% in June). Price growth in this segment was affected most strongly by prices of business services and services in real estate, which rose to 2.1% year on year in June (growth was recorded in particular for advertising and computer services). Q2 also saw renewed price growth in post and telecommunications services (to 4.2% in June) connected with an increase in telecommunication fees. Prices of national goods transport also grew faster than in the previous quarter. The price increase in these services seems to have been due not only to increased cost inputs (fuel), but also to growing demand for such services. Prices in financial intermediation rose more slowly on average than in the previous quarter.

CHART III.48
Inflation slowed in construction, while market services prices rose
(annual percentage changes)



37 Prices of potatoes saw an annual fall of 70.2%, while prices of vegetables and fruit declined by 29.5% and 28.1% respectively.

IV.1 EXTERNAL ASSUMPTIONS OF THE FORECAST

Expectations regarding the external environment are one of the key assumptions of the forecast. For this purpose, the CNB has as usual drawn on the publication Consensus Forecasts, which brings together the forecasts of a range of foreign analytical teams. The information published in its June issue does not significantly change the assessment of external effects on the Czech economy compared to the assumptions of the April forecast.

The CNB's forecasting system uses data on the German economy to proxy for developments in the Czech Republic's major trading partner countries. Compared to the previous forecast, the June prediction from Consensus Forecasts has not altered the outlook for German GDP growth, which remains at 0.9% for 2005 and 1.4% for 2006. By contrast, expectations regarding consumer price inflation have been revised slightly upwards, to 1.5% in 2005 and 1.3% in 2006. Expected growth in industrial producer prices has also been raised. The increase in the estimate is more significant for 2005 (0.6 percentage point, to 3.1%) and only moderate for 2006 (0.1 percentage point, to 1.5%).

TABLE IV.1

The price of Ural crude oil is expected to fall somewhat and then stabilise

	III/05	IV/05	I/06	II/06	III/06	IV/06	I/07	II/07
Ural crude oil prices (USD/barrel)	51.5	48.8	47.5	46.8	46.7	46.7	46.7	46.7
Natural gas prices (by import structure, USD/1000m^3)	206.9	210.6	211.0	210.1	109.1	208.3	207.8	207.4
GDP in Germany (annual, in per cent)	1.0	1.3	1.4	1.4	1.4	1.4	1.4	1.4
Producer price inflation in Germany (annual, in per cent)	2.7	1.4	0.8	0.7	1.9	2.6	2.2	1.5
Consumer price inflation in Germany (annual, in per cent)	1.4	1.1	1.2	1.0	1.4	1.7	1.7	1.5
Nominal USD/EUR exchange rate	1.234	1.247	1.257	1.272	1.283	1.285	1.287	1.288
1Y EURIBOR	2.1	2.0	2.0	2.1	2.1	2.2	2.2	2.3

Consensus Forecasts made another upward revision to oil prices. The current forecast assumes a Ural crude oil price of USD 45 a barrel in 2005 Q3, then a decline to just below USD 42 a barrel by the end of 2006 Q1 and oil price stability over the rest of 2006. Owing to the appreciation of the dollar in Q2, the expected evolution of the dollar-euro exchange rate has also been altered. The forecast assumes a stronger dollar in Q3. The dollar should, however, depreciate slightly over the following quarters. Expected one-year euro area interest rates have shifted significantly downwards over the entire forecast horizon. The reference scenario thus assumes a reduction in the 1Y EURIBOR nominal interest rate to 2% at the turn of 2005 and 2006 and subsequent modest growth during the course of 2006.

IV.2 INTERNAL ASSUMPTIONS OF THE FORECAST

In addition to assumptions regarding the external environment, assumptions about the domestic economy, including the expected impact of fiscal policy on the economy, are an important input to the forecast. Compared to the April forecast, the outlook for public finances in 2005 and 2006 has shifted towards lower deficits, owing to an expert adjustment made to the expenditure side of the public budgets. The favourable development of public budgets is confirmed *inter alia* by the slight state budget surplus in the first half of 2005. The estimated government sector deficit under ESA 95 methodology is close to the reality for 2004. The expected positive contribution of fiscal policy to GDP growth in 2005 has been therefore adjusted downwards and a slightly restrictive fiscal policy effect is expected for 2006.

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 settings of the monetary conditions, are determined as the difference between current and equilibrium values. The evolution of the equilibrium values then provides a framework for the fundamental orientation of the forecast. The variables that frame the forecast in this way include equilibrium real interest rates, the equilibrium real exchange rate and potential output (i.e. the non-accelerating inflation level of output).

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. These analyses draw on the linkages between these variables as perceived by the CNB's forecasting system.

Since the preparation of the April forecast, no information has emerged leading to a revision of the evolution of equilibrium real interest rates and the equilibrium real exchange rate. As in the previous forecast, the one-year real equilibrium interest rate is set at 1.4%. The equilibrium real exchange rate is expected to strengthen at a rate of between 2.5% and 3% for the next few quarters. It will, however, fall gradually year on year to 2% in 2007. The forecast assumes a growth rate of potential output (i.e. the non-accelerating inflation rate of output) of between 3.5% and 4%. The slight upward shift partly reflects a revision of the GDP growth figures.

The information on economic activity published since the April forecast confirmed in principle the previous forecasts of a gradual closing of the output gap. However, this closure has been slowing down this year as a result of the tighter exchange rate component of the real monetary conditions at the end of 2004 and at the beginning of 2005 and owing to the weak external demand. The output gap in 2005 Q2 was, however, partially revised towards slightly greater closure by comparison with the previous forecast, mainly in connection with the revision of the GDP figures for 2004.

In line with expectations, economic growth continued to be driven mainly by domestic exports and the related demand for fixed investment in 2005 Q1, although both these components slowed slightly. Export growth stayed relatively high thanks mainly to the lagged effect of the easy real exchange rate in 2004 and the launching of new facilities by foreign-controlled corporations. Private consumption slackened further owing to a decline in real disposable income in 2004, while government consumption recorded a significant year-on-year decline. Domestic exports slowed further in 2005 Q2 as a result of the continuing weak external recovery, the gradual appreciation of the real exchange rate and the unwinding of the one-off effect of EU accession. The savings rate continued to rise despite an estimated slight recovery in private consumption in Q2 and the favourable assessment of the consumer climate.

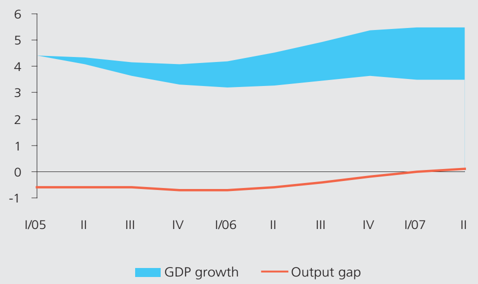
With the exception of oil prices, cost-push inflationary pressures weakened further in Q2, chiefly thanks to agricultural producer prices, import prices and industrial producer prices. The position of the economy in the business cycle also acted in the disinflationary direction. As a consequence of these factors, adjusted inflation excluding fuels saw a further slight decline in line with the forecast. The observed positive deviation of consumer prices in Q2 from the April forecast, amounting to 0.3 percentage point, was brought on chiefly by unexpected changes in regulated prices and rising fuel prices[38].

Overall, the current real monetary conditions, which affect the future business cycle, can be characterised as neutral to slightly easy. The exchange rate component is perceived as neutral, as the appreciation of the equilibrium real exchange rate – amid a stable nominal exchange rate and a decline in domestic inflation – has closed the small positive gap in the real exchange rate seen at the start of this year. The interest rate component is still regarded as slightly easy.

IV.3 THE MESSAGE OF THE FORECAST

Although the current forecast contains no major reassessment of economic growth in 2005 and 2006, the changes in domestic and foreign exogenous factors, and partly also the revision of the historical GDP figures, act towards stagnation of the output gap in the near future and towards slower closure thereof. The adjustment of the forecast reflects above all the estimated less easy fiscal policy this year and a

CHART IV.1
The output gap will close at the start of 2007
(annual percentage growth)



38 The average for the quarter; the deviation had a rising tendency during Q2, reaching 0.75 percentage points.

shift towards a slightly restrictive fiscal position next year. The monetary conditions in the next few quarters are expected to be somewhat tighter compared to the April forecast, but mostly remain slightly easy at the forecast horizon. The expected crossing of the potential output level is thus postponed for two quarters to the beginning of 2007. During the course of 2005 and 2006, this closure of the output gap will correspond to real GDP growth of around 4%.

Table IV.2
Economic growth will be driven by exports and investment
(annual percentage changes)

	2005	2006
Gross domestic product	4.1	4.2
Total domestic demand	4.4	5.0
of which:		
Household consumption	3.0	4.3
Government consumption	1.8	-0.6
Gross fixed capital formation	6.0	8.8
Imports of goods and services	11.7	11.2
Exports of goods and services	12.2	12.9
Net exports of goods and services in CZK bn	-235.9	-230.5

Economic growth will continue to be driven primarily by real exports and investment activity. Despite the unwinding of the level effect connected with EU entry, a tightening of the real exchange rate and a slowdown in external demand growth, the forecast expects a growth trend in the economy's export performance due to the inflow of foreign direct investment and the launching of related export-oriented facilities. In year-on-year terms, the rate of growth of exports will drop considerably in 2005 to 12% and increase slightly in 2006 to 13%.

Gross fixed capital formation will maintain its relatively fast growth in 2005 and 2006, with private and public investment developing differently. Corporate investment activity will be affected by the expected slowdown in export growth, but the still slightly easy interest rates, good corporate results and the inflow of actually allocated foreign direct investment will act against a significant slowdown in private investment. Growth in nominal capital expenditure of the public budgets is expected to remain roughly the same in 2005 and 2006 as last year. These factors will result in an only slight slowdown in gross fixed capital formation growth to 6% this year, with a tendency to accelerate slightly at the end of the year and on into 2006.

Table IV.3
The positive trends on the labour market will continue
(annual percentage changes)

	2005	2006
Real disposable income of households	5.3	4.9
Unemployment rate (in per cent)	9.7	9.3
Labour productivity	4.2	4.0
Current account deficit (ratio to GDP in per cent)	-3.4	-3.1
M2	5.3	5.9

Household consumption in 2005 will be influenced by the expected acceleration in both nominal and real gross disposable income. This will be due to favourable developments on the labour market, faster growth in the average wage and total employment, higher transfers from the public budgets and lower consumer price inflation. In 2005 H2, the slightly easy interest rate component of the monetary conditions will start to influence household consumption, which will thus record growth of around 3% in 2005. Real gross disposable income growth will be slightly slower in 2006 as a result of somewhat lower growth in the average wage and employment as well as higher consumer price inflation. However, the gradually prevailing effect of the easy interest rate component of the monetary conditions in 2004 H2 and 2005 will allow household consumption growth to increase to 4.3% in 2006. As regards the expenditure components of GDP, the revised forecast for the public budgets did not have a significant impact on the prediction for government consumption. The current outlook is for annual growth in public sector consumption of 1.8% this year, whereas in 2006 it is expected to decline by 0.6%.

Growth in real exports of goods and services will, on the one hand, be affected by the expected decline in export growth; on the other hand, the domestic demand recovery, generated by the upswing in private consumption growth and continuing relatively high gross investment growth, will act in the opposite direction. Together with the effects of the tighter real exchange rate, this will result in import growth almost keeping pace with export growth over the entire forecast horizon and the real net export deficit widening.

The nominal exchange rate is forecasted to be stable at the current level during the rest of 2005 and in 2006. The outlook for import prices is slightly higher than the April forecast as a result of the appreciation of the US dollar, expected stronger growth in prices of energy-producing materials and higher inflation abroad.

The expected inflation path is determined by the combined demand-pull pressures resulting from real economic activity, imported inflation and other exogenous factors. The increase in the inflation forecast over the entire forecast horizon is mainly due to the revision of the predictions for regulated prices and fuel prices. At the monetary policy horizon, the inflation forecast is close to the point target or slightly below it.

In contrast to the April forecast, the inflation expected for the end of 2005 increased from 1.6% to 2.6%. The forecast is for annual inflation of 2.5% at the end of 2006. As mentioned above, the prediction has been increased in both years primarily in the case of regulated prices and fuel prices. The higher inflation in these categories will lead to a rise in inflation expectations. This fact, together with higher growth in import prices, results in higher adjusted inflation excluding fuels over the entire forecast horizon despite the slower closure of the output gap. In 2006, the main inflation factors should be a gradual pick-up in import price growth, renewed growth in agricultural producer prices and resumed closure of the output gap. The slowly closing negative output gap and the gradual pick-up in import price growth will cause inflation to remain close to the point target at the monetary policy horizon even after the strongest pressure of administrative price effects has unwound. In 2007, i.e. beyond the monetary policy horizon, further moderate growth in inflation can be expected due to demand-pull inflationary pressures and changes to indirect taxes (the final phase of the harmonisation changes to excise duties on tobacco products).

Consistent with the forecast and its assumptions is interest rate stability over the next several quarters and a slight rise in rates thereafter.

During the preparation of the July forecast, an alternative scenario was drawn up which simulates growth in oil prices of 30% in Q3 and subsequent oil price stability at the resulting level for one year. The simulations show that such oil price growth would lead to a moderate slowdown in external economic activity amid higher inflation abroad, which would imply higher foreign interest rates, and to a moderate appreciation of the dollar against the euro. Higher oil prices and higher prices abroad would consequently increase domestic import prices and domestic inflation. However, the slowdown in external real economic activity would result in a decline in Czech exports and slower closure of the output gap. Domestic interest rates would have to react to the koruna depreciation pressures caused by the higher foreign interest rates in a climate of prevailing inflationary cost pressures. This would result in an initially wider output gap and higher inflation over the entire horizon, which implies a higher level of domestic interest rates compared to the baseline scenario.

CHART IV.2
The inflation forecast is near to the point inflation target at the monetary policy horizon
(annual consumer price inflation; percentages)

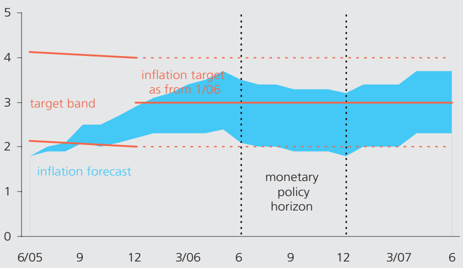


TABLE IV.4
Growth of inflation will be driven by regulated prices and fuel prices
(annual percentage growth)

	III/05	IV/05	I/06	II/06	III/06	IV/06	I/07	II/07
Annual consumer price inflation	2,0	2,3	2,7	2,9	2,6	2,6	2,7	3,0
Breakdown into contributions:								
regulated prices	6,9	6,3	5,5	5,1	3,2	3,1	2,2	2,9
indirect taxes (contributions in p.p.)	0,2	0,3	0,4	0,6	0,6	0,4	0,6	0,7
food prices, excluding effects of indirect taxes	-0,6	0,1	0,4	0,8	1,3	1,4	1,5	1,8
fuel prices, excluding effects of indirect taxes	5,8	7,4	16,7	6,5	3,1	1,1	-0,3	-0,6
adjusted inflation excluding fuels, excluding effects of indirect taxes	1,0	1,0	1,3	1,6	1,9	2,2	2,5	2,6

IV.4 EXPECTATIONS OF ECONOMIC AGENTS

The inflation outturns expected by financial market participants decreased slightly. Analysts expect inflation to gradually rise in the near term, mainly due to administrative measures (excise duty on tobacco, rents, electrical energy). The analysts also expect an increase in consumer demand, which should lead to a gradual rise in retail prices. On the other hand, prices of imported consumer goods should help to slow inflation. The future development of the koruna's exchange rate and food prices will be important factors. Annual inflation should only slightly exceed 2%. The inflation expectations of corporations are unchanged. Conversely, a rise was recorded for households, but their expectations have long been highly volatile.

The CNB also monitors inflation expectations at the three-year horizon. The inflation expectations of the financial market at this horizon are below the CNB's target of 3%, while the expectations of corporations are currently just above this level.

Expected interest rates decreased slightly in the period under review. The interest rate path consistent with the aforementioned CNB forecast was roughly in line with the expectations of financial market analysts over the entire horizon.

TABLE IV.5
The inflation expectations of the financial markets and corporations were slightly below the CNB's target
(percentages)

	12/04	3/05	4/05	5/05	6/05
Consumer price index					
1Y horizon:					
Financial market	2.8	2.6	2.5	2.4	2.3
Corporations	3.2	2.7			2.7
Households	1.5	3.8			4.2
3Y horizon:					
Financial market	2.8	2.6	2.5	2.4	2.5
Corporations	2.7	2.8			3.1
Households	1.8	3.8			6.0
1Y PRIBOR					
1Y horizon:					
Financial market	3.4	2.6	2.7	2.3	2.3

MINUTES OF THE BOARD MEETING ON 28 APRIL 2005

Present at the meeting:
Z. Tůma (Governor), L. Niedermayer (Vice-Governor), M. Singer (Vice-Governor), M. Erbenová (Chief Executive Director), J. Frait (Chief Executive Director), R. Holman (Chief Executive Director), P. Řežábek (Chief Executive Director)

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

The new forecast had revised the inflation prediction downwards compared to the January 2005 forecast. In addition to other effects, this was due above all to an anti-inflationary exchange rate effect and a worse economic outlook for the Czech Republic's major trading partners. According to the new forecast, inflation would be below the inflation target at the monetary policy horizon and would remain low until the end of 2006. During 2006 the forecast expected the anti-inflationary effect of import prices to unwind and demand-pull inflationary pressures to mount gradually. Inflation was expected to return to the target only in 2007. The easing of inflationary pressures in the forecast was due primarily to adjusted inflation excluding fuels and, in the shorter term, food price inflation.

The forecast was predicting continuing economic growth based on exports and investment. This notwithstanding, a tighter exchange rate would lead to a slowdown in export growth. By comparison with the January forecast, a rise in the fiscal impulse in 2005 was also predicted. At the same time, the rate of growth of output that generates no inflation pressures (potential output) had been revised upwards. These factors would cause the demand pressures linked with closure of the output gap to emerge later and with lower intensity compared to the January forecast.

Consistent with the baseline scenario of the forecast was a decline in interest rates in the period immediately ahead and flat interest rates thereafter.

After the presentation of the situation report, the Board discussed the new forecast and the associated risks. In the discussion, the view was expressed that once the anti-inflationary exchange rate shock had unwound and the output gap had closed, inflation at the monetary policy horizon might be higher than envisaged in the baseline scenario of the forecast. The forecast-consistent interest rates might then be excessively low. By contrast, the opinion was also expressed that further appreciation of the exchange rate was also a risk, as this might generate a further fall in inflation far below the target and towards values approaching deflation.

A consensus was reached that the downside and upside risks to the baseline scenario of the forecast were balanced overall. The possibility of a further growth slowdown in the Czech Republic's major trading partner nations compared to the assumptions of the baseline scenario, and continuing appreciation of the exchange rate, were considered to be the main downside risks to the inflation forecast. The possibility of higher-than-expected oil prices and the possibility of weaker pass-through of changes in the exchange rate into inflation were identified as upside risks to the inflation forecast. The hard-to-estimate effect of fiscal policy was viewed as a two-sided risk, increasing the overall uncertainty of the forecast.

The Board discussed the usefulness of lowering interest rates. Opinions were expressed that this would constitute excessively activist monetary policy, which could not offset the effects of the structural changes and cost shocks causing the decline in inflation. Against this was the argument – based on the logic of the forecast – that the open output gap, the higher growth in potential, the low initial inflation and the below-target inflation prediction allowed a reduction of rates. It was mentioned that the inflation forecast was heading below the target even on the assumption of a lowering of rates.

The Board agreed that the fact that lowering rates would take them below the level in the euro area did not constitute a significant factor in the decision on the level of rates.

Some board members expressed the concern that the low interest rate level might present a risk to financial stability. Opinions were also expressed that this was not a sufficient reason for leaving rates at their present level, as the interest rate reduction under discussion did not pose a risk of excessive credit growth.

After discussing the 4th situation report, the Board decided by a majority vote to lower the two-week repo rate by 0.25 percentage point to 1.75% with effect from 29 April 2005. At the same time it decided to reduce the discount rate and Lombard rate by the same amount, to 0.75% and 2.75% respectively. Four members voted in favour of this decision, and three members voted for leaving rates unchanged.

MINUTES OF THE BOARD MEETING ON 26 MAY 2005

Present at the meeting:
Z. Tůma (Governor), L. Niedermayer (Vice-Governor), M. Singer (Vice-Governor), M. Erbenová (Chief Executive Director), J. Frait (Chief Executive Director), R. Holman (Chief Executive Director), P. Řežábek (Chief Executive Director)

The meeting opened with a presentation of the May situation report, which assessed the new information and the risks associated with the fulfilment of the April macroeconomic forecast.

In April the consumer price index had recorded a year-on-year rise of 1.6%, which was 0.1 percentage point higher than forecasted. The deviation was a result of higher-than-expected growth in fuel prices. Import prices in April had been only slightly lower than forecasted, whereas agricultural producer prices had fallen more sharply. By contrast, industrial producer price inflation had been rather higher than forecasted.

Worse-than-forecasted figures for both industrial and construction output, suggesting slowing investment growth, as well as the leading growth indicators signalled lower-than-expected GDP growth in the past quarter. Information from the labour market indicated lower-than-forecasted growth in wages and salaries. Unemployment was in line with the forecast, as was the exchange rate.

After the presentation of the situation report, the Board discussed the risks associated with the fulfilment of the April forecast. The board members agreed that the risks of the forecast could be assessed as balanced. It was said that the new data had confirmed the positioning of the forecast and that there was no reason to change the assessment of the macroeconomic situation. The current interest rate settings were consistent with the forecast. The Czech economy remained a low-inflation economy, and there were no major demand-pull inflationary pressures visible at the monetary policy horizon.

The Board agreed that developments in the euro area posed the most significant anti-inflationary risk. Specifically, the potential economic growth slowdown in the euro area could cause the ECB to lower interest rates. Some of the board members expressed concerns about domestic economic growth, referring to the probable slowdown in investment growth. It was also noted that economic growth in 2005 Q1 might have been slowed by the appreciation of the koruna at the end of last year and the beginning of this year. It was hypothesized that accession to the EU had constituted a positive exogenous shock that had boosted economic growth, and that this positive effect was now waning.

The Board stated that the greatest internal risk was uncertainty over fiscal developments and that this represented an upside risk to inflation. On one side were the obligations of the Czech Republic and the plan approved by the Ministry of Finance and the government, and on the other side were recent remarks made by members of the government which went in a different direction and admitted the possibility of higher-than-planned deficits. The effect of fiscal policy on the economy was therefore exceedingly difficult to predict.

The Board also turned its attention to the exchange rate. It was said in the discussion that the recent weakening of the exchange rate should not be overplayed. The depreciation was linked more with developments in the region than with developments in the domestic economy. In this regard, the board members agreed that the risk of a unidirectional movement of the exchange rate had passed and that the exchange rate uncertainty was currently distributed symmetrically.

The settings of the monetary conditions in the euro area and their effect on the Czech economy were also discussed. Some of the board members expressed doubts about the sustainability of the negative interest rate differential between domestic and euro area rates. In this regard it was again emphasized that domestic rates were at the right level given the low domestic inflation.

After discussing the situation report, the Board decided unanimously to leave the two-week repo rate unchanged at 1.75%.

MINUTES OF THE BOARD MEETING ON 30 JUNE 2005

Present at the meeting:
Z. Tůma (Governor), L. Niedermayer (Vice-Governor), M. Singer (Vice-Governor), J. Frait (Chief Executive Director), R. Holman (Chief Executive Director), P. Řežábek (Chief Executive Director)

The Board discussed the June situation report, which analysed the new statistical data and assessed the risks associated with the fulfilment of the April macroeconomic forecast.

In May of this year, the consumer price index had recorded a year-on-year rise of 1.3%, as compared to the 1.1% expected by the CNB. The deviation from the forecast had been due primarily to higher growth in food and fuel prices. The faster growth in fuel prices than forecasted by the CNB reflected higher world oil prices than those considered in the reference scenario of the April macroeconomic forecast. The deviation in food price inflation was due to large seasonal swings, in this case chiefly in fruit and vegetable prices. Adjusted inflation excluding fuels in May had moved in line with the forecast (rising by 0.9 year on year, compared to the expected 0.8%). Annual industrial producer price inflation in May had also been consistent with the forecast. The decline in agricultural producer prices in May had conversely been larger than expected by the CNB.

Year-on-year GDP growth had been 4.4% in 2004 Q1, slightly exceeding the CNB's forecasts. The individual items within the economic growth structure had deviated from the forecast. Real exports had been better than forecasted, whereas imports had been worse. The result was a lower-than-forecasted real net export deficit. Gross fixed capital formation and consumption of households and general government had conversely lagged behind the forecast assumptions. The highest growth in value added in Q1 had been in the services sector, whereas industry and the economy as a whole had recorded a slowdown in value added growth. There had been a further improvement in labour productivity in the same period. However, the corporate financial indicators had worsened somewhat. Employment and unemployment were in line with the CNB's expectations. Wage growth was more subdued than forecasted by the CNB.

After the presentation of the situation report, the Board assessed the risks to the fulfilment of the April forecast. The board members agreed that the monetary conditions were not diverging significantly from the forecast. The new data on the economy essentially confirmed the April macroeconomic forecast, and the current interest rate settings were consistent with the forecast.

During the assessment of the upside risks to inflation, the main emphasis was put on growth in world oil prices, whose future dynamics and implications should not be underestimated, among other things, in relation to the development of the dollar exchange rate. In the discussion of the downside risks to inflation, particular attention was drawn to the low growth outlook in the euro area countries.

The Board agreed that the individual risks generally had only a slight quantitative impact on inflation and interest rates going forward. The risks were currently broadly balanced and were not generating any major signals for a change in monetary policy rates. Within this broad consensus, the opinion was also expressed that the downside risks might prevail in the future – in addition to the pessimistic outlook for external economic growth, attention was drawn to the potential future slackening of domestic growth signalled by the leading indicators, the slowing pace of investment activity and the less positive financial results in the corporate sector. However, it would be possible to assess the seriousness of these risks only in the light of new economic figures, and no monetary policy response was necessary at present.

In its discussion of the risks, the Board then turned its attention to two sets of problems: fiscal issues and the economic growth structure. As regards fiscal developments, the Board agreed that despite the favourable state budget results for the first half of 2005 it was still necessary, with regard to the CNB's macroeconomic forecast, to view the full-year fiscal expenditure level as a risk acting in both directions. The structure of domestic economic growth was also discussed in more detail. Although the aggregate growth in real GDP in 2005 Q1 was broadly in line with the CNB's forecasts, there had been a slowdown in investment growth, with the current growth being driven chiefly by exports. To what extent the present economic growth was sustainable in these circumstances, and how the changes in the growth structure would affect the economy's potential, were therefore a matter for further analysis. In this context the sustainability of the favourable current account development was also discussed.

After discussing the situation report, the Board decided unanimously to leave the two-week repo rate unchanged at 1.75%.

MINUTES OF THE BOARD MEETING ON 28 JULY 2005

Present at the meeting:
Z. Tůma (Governor) - departed during the meeting, L. Niedermayer (Vice-Governor), M. Erbenová (Chief Executive Director), J. Frait (Chief Executive Director), P. Řežábek (Chief Executive Director).

The Board discussed the July situation report, containing the new forecast for inflation and other macroeconomic variables, and the risks associated with the new forecast.

A low-inflation environment still persisted in the economy. The fall in headline inflation had halted at the end of the second quarter of 2005. The consumer price index had risen more year on year in June than predicted by the April forecast. The main reason for this had been higher-than-expected growth in administered prices (especially in telecommunications), food prices and fuel prices. Adjusted inflation excluding fuels had slowed as expected. The new inflation forecast had shifted upwards over the entire transmission horizon relative to the April forecast. Even after this correction, the forecast for inflation at the horizon of most effective transmission was just below the target.

The economy was in a growth phase of the business cycle. The GDP growth forecast was little changed from April. According to the new forecast, however, the growth would slacken over the next few quarters before picking up pace again. The output gap in the new forecast was narrowing rather more slowly, and would close in 2007. The unemployment rate was continuing to fall. By comparison with April, the forecast was based on an assumption of a smaller fiscal impulse, higher oil prices, a stronger dollar and lower rates in the euro area.

Consistent with the July forecast and its assumptions was interest rate stability over the next several quarters and a slight rise in rates thereafter.

After the presentation of the situation report, the Board discussed the new inflation forecast and economic developments. The Board agreed that the Czech economy was in a phase of low inflation and a growth phase of the economic cycle, and that the outlook at the horizon of most effective monetary transmission painted an equally stable picture.

There was also a consensus that the July forecast differed from the April forecast chiefly in that it took into consideration the impacts of cost shocks in the area of oil prices and administered prices. In this regard, it was said that the effect of the shocks on the forecast was fairly sizeable thanks to the fact that inflation in the Czech economy was nominally very low. It was also said that inflation in the Czech economy was low despite the fact that the cost shocks were significant. It was mentioned that one of the hypotheses explaining why this was so was the hypothesis on the formation of inflation expectations. Such expectations in the Czech economy reflected the transitory nature of the cost shocks, were increasing at a lower rate than would correspond to the size of the cost shocks, and hence were not generating pressure for inflation to accelerate. Another argument given in the discussion of the small observed impact of the cost shocks on inflation was the existence of adjustment mechanisms in the economy. The factors helping to depress the effects of cost factors on inflation included a fall in the share of wages in value added and partly also the appreciation of the koruna. It was also said that the rise in administered prices – one of the cost shocks increasing inflation – had also not fully passed through to prices. This may have been because this rise was curbing demand in other segments of the economy and hence partly reducing the demand pressure on inflation. This lower demand-pull inflationary pressure was to a large extent offsetting the effect of the original supply shock. In this context it was also noted that the demand-pull inflationary pressures were moreover being depressed by the smaller-than expected fiscal impulse.

The Board agreed that the risks of the July forecast were slight and symmetrical. The view was expressed that if the risks were at all skewed, they were skewed to the upside, but this skewing was very small and did not require any monetary policy response at the present time. On the other hand, it was said that these were not so much risks as just uncertainties of the forecast. It was said that the uncertainties of the forecast included, for instance, developments abroad, which may have been affected by the stronger-than-expected dollar and the faster-than-expected recovery in Germany. If these uncertainties were moved to the risk category, they would generate an upside skew to the risks of the July forecast. The view was repeatedly expressed that a change in expectations regarding the evolution of euro area rates would, via the interest rate differential, significantly affect the forecast assumptions. During the discussion of the risks and uncertainties, the view was expressed that the favourable figures on employment growth were two-thirds due to a rise in employment in the health and education sectors, and so the aggregate data painted an over-optimistic picture of developments in the labour market. It was also said that the positive outlook was based on an assumption of sustainable investment growth and that EU funds could help maintain the rate of growth of the economy. However, an increased inflow of such funds would not necessarily have an equally positive effect on the economy as efficient private investment, despite the attainment of a comparable rate of growth in the short run.

At the end of the meeting, the Board decided unanimously to leave the two-week repo rate unchanged at 1.75%.

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Table 1a

INFLATION DEVELOPMENT annual percentage changes

2001	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**
Consumer prices	4.2	4.0	4.1	4.6	5.0	5.5	5.9	5.5	4.7	4.4	4.2	4.1
Regulated prices	10.3	10.4	10.6	10.8	10.7	10.4	11.5	11.8	11.9	11.8	11.7	11.7
(contribution to consumer price inflation)	1.95	1.98	2.01	1.98	2.00	1.97	2.12	2.19	2.19	2.19	2.16	2.17
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	-0.18	-0.18	-0.18	0.00	0.00	0.00	0.01	0.01	0.05	0.05	0.05	0.05
Net inflation	3.0	2.9	2.9	3.3	3.8	4.4	4.7	4.1	3.1	2.7	2.4	2.4
(contribution to consumer price inflation)	2.37	2.23	2.24	2.62	2.97	3.52	3.74	3.31	2.54	2.15	1.98	1.92
of which: prices of food, beverages and tobacco	3.8	3.5	4.2	5.5	6.0	7.7	6.9	5.1	4.0	2.9	2.6	2.9
(contribution to consumer price inflation)	1.09	1.02	1.25	1.62	1.78	2.24	2.11	1.70	1.28	0.97	0.87	0.80
adjusted inflation	2.5	2.4	2.0	1.9	2.3	2.4	3.2	3.4	2.5	2.4	2.3	2.1
(contribution to consumer price inflation)	1.28	1.21	0.99	1.00	1.18	1.27	1.63	1.62	1.26	1.17	1.11	1.12
Inflation rate (annual moving average)	4.0	4.0	4.0	4.1	4.2	4.3	4.5	4.6	4.7	4.7	4.7	4.7
2002												
Consumer prices	3.7	3.9	3.7	3.2	2.5	1.2	0.6	0.6	0.8	0.6	0.5	0.6
Regulated prices	7.6	8.1	8.0	6.5	6.3	6.3	5.3	5.0	4.9	3.4	3.4	3.3
(contribution to consumer price inflation)	1.49	1.60	1.59	1.28	1.24	1.22	1.05	0.98	0.98	0.69	0.69	0.66
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.00	0.00	0.00	0.00
Net inflation	2.7	2.7	2.5	2.4	1.5	-0.1	-0.6	-0.6	-0.3	-0.1	-0.2	-0.2
(contribution to consumer price inflation)	2.20	2.15	2.01	1.89	1.20	-0.12	-0.47	-0.46	-0.22	-0.11	-0.18	-0.15
of which: prices of food, beverages and tobacco	3.2	3.0	2.3	1.7	0.6	-2.6	-3.6	-3.5	-2.9	-3.0	-3.2	-3.4
(contribution to consumer price inflation)	0.88	0.82	0.65	0.47	0.16	-0.72	-0.97	-0.96	-0.79	-0.80	-0.87	-0.93
adjusted inflation	2.5	2.5	2.6	2.7	2.0	1.1	0.9	0.9	1.1	1.3	1.3	1.5
(contribution to consumer price inflation)	1.32	1.33	1.37	1.43	1.04	0.60	0.50	0.50	0.56	0.69	0.69	0.79
Inflation rate (annual moving average)	4.6	4.6	4.6	4.5	4.3	3.9	3.5	3.1	2.7	2.4	2.1	1.8
2003												
Consumer prices	-0.4	-0.4	-0.4	-0.1	0.0	0.3	-0.1	-0.1	0.0	0.4	1.0	1.0
Regulated prices	-0.3	-0.8	-0.8	1.4	1.5	1.5	0.4	0.4	0.4	1.2	1.2	1.3
(contribution to consumer price inflation)	-0.07	-0.15	-0.16	0.29	0.31	0.32	0.08	0.09	0.08	0.24	0.24	0.27
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net inflation	-0.4	-0.2	-0.2	-0.5	-0.4	0.0	-0.2	-0.1	0.0	0.3	0.9	1.0
(contribution to consumer price inflation)	-0.32	-0.17	-0.15	-0.38	-0.30	-0.01	-0.19	-0.10	-0.01	0.20	0.70	0.77
of which: prices of food, beverages and tobacco	-4.1	-3.8	-3.5	-3.5	-2.8	-1.0	-0.9	-0.9	-0.1	0.6	2.5	2.7
(contribution to consumer price inflation)	-1.06	-1.06	-0.97	-0.94	-0.76	-0.28	-0.22	-0.22	-0.04	0.16	0.66	0.70
adjusted inflation	1.5	1.7	1.5	1.1	0.9	0.5	0.1	0.2	0.0	0.1	0.1	0.1
(contribution to consumer price inflation)	0.74	0.89	0.82	0.56	0.46	0.27	0.04	0.12	0.02	0.04	0.04	0.06
Inflation rate (annual moving average)	1.5	1.1	0.8	0.5	0.3	0.2	0.2	0.1	0.0	0.0	0.1	0.1
2004												
Consumer prices	2.3	2.3	2.5	2.3	2.7	2.9	3.2	3.4	3.0	3.5	2.9	2.8
Regulated prices	5.0	4.9	4.7	3.1	2.4	2.4	2.4	2.3	2.3	4.4	4.4	4.4
(contribution to consumer price inflation)	1.01	0.99	0.96	0.63	0.49	0.49	0.49	0.47	0.46	0.90	0.89	0.89
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.35	0.35	0.35	0.39	0.61	0.68	0.72	0.73	0.76	0.76	0.76	0.76
Net inflation	1.2	1.2	1.4	1.5	2.0	2.1	2.5	2.6	2.3	2.1	1.6	1.5
(contribution to consumer price inflation)	0.96	0.92	1.15	1.21	1.63	1.71	2.02	2.11	1.81	1.71	1.28	1.20
of which: prices of food, beverages and tobacco	2.8	2.8	3.2	3.3	3.4	2.7	3.8	4.2	3.0	2.2	0.7	0.9
(contribution to consumer price inflation)	0.75	0.75	0.83	0.86	0.89	0.71	1.00	1.10	0.78	0.59	0.18	0.25
adjusted inflation	0.4	0.3	0.6	0.6	1.4	1.9	1.9	1.9	1.9	2.1	2.1	1.8
(contribution to consumer price inflation)	0.21	0.17	0.32	0.35	0.74	1.00	1.02	1.02	1.03	1.12	1.10	0.96
Inflation rate (annual moving average)	0.3	0.5	0.8	1.0	1.2	1.4	1.7	2.0	2.2	2.5	2.7	2.8
2005												
Consumer prices	1.7	1.7	1.5	1.6	1.3	1.8						
Regulated prices	2.9	2.9	2.9	3.1	4.0	5.8						
(contribution to consumer price inflation)	0.61	0.60	0.61	0.66	0.83	1.21						
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.35	0.35	0.35	0.31	0.09	0.02						
Net inflation	0.9	0.9	0.7	0.8	0.6	0.7						
(contribution to consumer price inflation)	0.72	0.75	0.59	0.68	0.46	0.53						
of which: prices of food, beverages and tobacco	0.4	0.6	0.4	-0.1	-0.1	0.2						
(contribution to consumer price inflation)	0.11	0.17	0.12	-0.02	-0.03	0.04						
adjusted inflation	1.1	1.1	0.9	1.3	0.9	0.9						
(contribution to consumer price inflation)	0.61	0.59	0.47	0.69	0.49	0.48						
Inflation rate (annual moving average)	2.8	2.7	2.6	2.6	2.5	2.4						

CNB calculation based on CZSO data

Table 1b

INFLATION DEVELOPMENT monthly percentage changes

2001	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**
Consumer prices	1.9	0.0	0.1	0.4	0.6	1.0	1.0	-0.2	-0.7	0.0	-0.1	0.1
Regulated prices	7.7	0.3	0.2	0.3	0.0	0.1	2.1	0.3	0.2	0.1	0.0	0.0
(contribution to consumer price inflation)	1.43	0.05	0.05	0.06	0.00	0.01	0.41	0.06	0.04	0.03	-0.01	0.01
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.00	0.00	0.00	0.00	0.00	0.00	0.01	0.00	0.05	0.00	0.00	0.00
Net inflation	0.6	0.0	0.0	0.4	0.8	1.3	0.7	-0.3	-1.0	-0.1	-0.1	0.2
(contribution to consumer price inflation)	0.45	0.01	-0.01	0.31	0.57	1.07	0.56	-0.21	-0.82	-0.10	-0.05	0.10
of which: prices of food, beverages and tobacco	1.2	-0.2	0.1	0.7	0.8	2.0	-0.9	-1.0	-0.8	0.0	0.0	0.9
(contribution to consumer price inflation)	0.33	-0.06	0.03	0.19	0.23	0.56	-0.24	-0.27	-0.21	0.00	-0.01	0.24
adjusted inflation	0.2	0.1	-0.1	0.2	0.7	1.0	1.5	0.1	-1.2	-0.2	-0.1	-0.3
(contribution to consumer price inflation)	0.12	0.07	-0.04	0.12	0.34	0.51	0.81	0.06	-0.62	-0.10	-0.03	-0.14
2002												
Consumer prices	1.5	0.2	-0.1	-0.1	-0.1	-0.3	0.5	-0.2	-0.5	-0.3	-0.2	0.2
Regulated prices	3.7	0.8	0.2	-1.1	-0.1	0.0	1.1	0.0	0.1	-1.3	0.0	-0.1
(contribution to consumer price inflation)	0.75	0.16	0.04	-0.23	-0.03	0.00	0.23	-0.01	0.03	-0.26	0.00	-0.02
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net inflation	0.9	0.0	-0.2	0.2	-0.1	-0.3	0.3	-0.2	-0.7	0.0	-0.1	0.2
(contribution to consumer price inflation)	0.74	-0.03	-0.14	0.20	-0.11	-0.24	0.20	-0.19	-0.58	0.01	-0.11	0.13
of which: prices of food, beverages and tobacco	1.5	-0.4	-0.5	0.1	-0.3	-1.2	-1.9	-1.0	-0.1	0.0	-0.3	0.7
(contribution to consumer price inflation)	0.41	-0.11	-0.14	0.01	-0.08	-0.32	-0.50	-0.25	-0.03	-0.01	-0.08	0.18
adjusted inflation	0.6	0.2	0.0	0.3	-0.1	0.2	1.3	0.1	-1.0	0.0	-0.1	-0.1
(contribution to consumer price inflation)	0.33	0.08	0.00	0.18	-0.04	0.08	0.70	0.07	-0.56	0.02	-0.03	-0.05
2003												
Consumer prices	0.6	0.2	-0.1	0.2	0.0	0.0	0.1	-0.2	-0.5	0.1	0.5	0.2
Regulated prices	0.1	0.3	0.2	1.1	-0.1	0.0	0.0	0.0	0.1	-0.4	0.0	0.0
(contribution to consumer price inflation)	0.03	0.06	0.03	0.23	-0.01	0.01	0.00	0.00	0.01	-0.09	0.00	0.00
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net inflation	0.7	0.2	-0.2	0.0	0.0	0.1	0.0	-0.1	-0.6	0.3	0.5	0.3
(contribution to consumer price inflation)	0.55	0.14	-0.13	-0.03	-0.04	0.05	0.03	-0.11	-0.49	0.22	0.39	0.20
of which: prices of food, beverages and tobacco	0.8	-0.2	-0.2	0.1	0.4	0.6	-1.7	-1.0	0.6	0.7	1.6	0.8
(contribution to consumer price inflation)	0.22	-0.05	-0.05	0.04	0.10	0.16	-0.44	-0.25	0.16	0.18	0.42	0.22
adjusted inflation	0.6	0.3	-0.1	-0.1	-0.3	-0.2	0.9	0.3	-1.2	0.1	-0.1	0.0
(contribution to consumer price inflation)	0.33	0.18	-0.07	-0.06	-0.14	-0.11	0.47	0.15	-0.65	0.03	-0.03	-0.02
2004												
Consumer prices	1.8	0.2	0.1	0.0	0.4	0.2	0.4	0.0	-0.8	0.5	-0.1	0.1
Regulated prices	3.7	0.2	0.0	-0.5	-0.7	0.0	0.0	-0.1	0.0	1.6	0.0	0.0
(contribution to consumer price inflation)	0.76	0.04	0.01	-0.10	-0.15	0.00	0.00	-0.03	0.01	0.34	-0.01	0.00
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	0.35	0.00	0.00	0.04	0.23	0.07	0.04	0.01	0.03	0.00	0.00	0.00
Net inflation	0.9	0.1	0.1	0.0	0.5	0.1	0.4	0.0	-1.0	0.2	0.0	0.2
(contribution to consumer price inflation)	0.74	0.09	0.10	0.03	0.37	0.12	0.33	-0.01	-0.78	0.12	-0.04	0.12
of which: prices of food, beverages and tobacco	1.0	-0.2	0.1	0.3	0.5	-0.1	-0.6	-0.6	-0.6	0.0	0.0	1.1
(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
2005												
Consumer prices	0.7	0.2	-0.1	0.1	0.2	0.6						
Regulated prices	2.2	0.2	0.1	-0.2	0.1	1.8						
(contribution to consumer price inflation)	0.48	0.04	0.01	-0.05	0.02	0.39						
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	-0.06	0.00	0.00	0.00	0.00	0.00						
Net inflation	0.3	0.2	-0.1	0.1	0.2	0.2						
(contribution to consumer price inflation)	0.26	0.13	-0.06	0.11	0.15	0.19						
of which: prices of food, beverages and tobacco	0.5	0.0	-0.1	-0.2	0.5	0.2						
(contribution to consumer price inflation)	0.12	0.01	-0.02	-0.06	0.12	0.05						
adjusted inflation	0.3	0.2	-0.1	0.3	0.1	0.3						
(contribution to consumer price inflation)	0.14	0.11	-0.04	0.17	0.03	0.14						

CNB calculation based on CZSO data

Table 2

CONSUMER PRICES percentage changes; December 1999 = 100

Group	Constant 1999 weights in per mille	Months 1	2	3	4	5	6	7	8	9	10	11	12	Average since start of year
Total - 2001	1,000.0	6.1	6.1	6.2	6.6	7.2	8.3	9.4	9.2	8.4	8.4	8.3	8.4	7.7
Total - 2002	1,000.0	10.0	10.2	10.1	10.0	9.9	9.6	10.1	9.9	9.3	9.0	8.8	9.0	9.7
Food and non-alcoholic beverages	197.6	10.0	9.4	8.7	8.3	7.8	6.0	3.2	1.7	1.5	1.4	1.0	2.1	5.1
Alcoholic beverages and tobacco	79.2	5.8	5.8	5.6	6.8	7.0	7.0	7.1	7.3	7.4	7.5	7.4	7.1	6.8
Clothing and footwear	56.9	-4.7	-5.5	-5.7	-5.7	-5.7	-5.8	-6.4	-7.4	-7.4	-7.4	-7.4	-7.7	-6.4
Housing, water, electricity, gas and other fuels	236.4	23.5	23.6	23.7	22.6	22.6	22.6	24.9	25.0	25.0	24.2	24.3	24.3	23.9
Furnishings, household equipment and routine maintenance of the house	67.9	-0.4	-0.5	-0.3	-0.3	-0.3	-0.4	-0.5	-0.7	-0.7	-0.8	-0.9	-1.0	-0.6
Health	14.3	9.2	9.7	10.1	10.2	10.9	11.2	12.9	13.1	13.3	13.0	12.8	12.8	11.6
Transport	101.4	3.0	3.0	3.3	5.5	5.1	4.7	4.1	3.9	5.1	4.9	4.6	4.1	4.3
Communications	22.5	6.0	11.4	11.3	11.3	9.9	9.9	11.1	11.0	11.6	9.4	9.3	8.2	10.0
Recreation and culture	95.5	7.4	8.5	7.9	7.2	7.0	8.4	13.8	15.2	7.3	7.2	7.0	7.2	8.7
Education	4.5	6.9	7.0	7.0	7.0	7.0	7.0	7.0	7.0	10.7	11.3	11.3	11.3	8.4
Hotels, cafés and restaurants	74.2	6.4	7.0	7.4	7.9	8.0	8.2	8.4	8.4	8.5	8.6	8.6	8.7	8.0
Miscellaneous goods and services	49.5	11.0	11.2	11.3	11.6	11.6	11.5	11.5	11.4	11.7	11.9	12.0	11.9	11.6
Total - 2003	1,000.0	9.6	9.8	9.7	9.9	9.9	9.9	10.0	9.8	9.3	9.4	9.9	10.1	9.8
Food and non-alcoholic beverages	197.6	3.1	2.8	2.5	2.7	3.2	4.2	1.7	0.3	1.1	2.2	4.4	5.7	2.8
Alcoholic beverages and tobacco	79.2	7.6	7.7	7.7	7.7	7.9	7.6	7.7	7.7	7.9	7.7	8.0	7.8	7.8
Clothing and footwear	56.9	-9.1	-10.0	-10.4	-10.1	-10.1	-10.4	-11.5	-12.6	-12.4	-12.1	-11.9	-11.9	-11.0
Housing, water, electricity, gas and other fuels	236.4	24.9	25.3	25.4	26.5	26.6	26.6	26.9	27.0	27.0	26.6	26.6	26.6	26.3
Furnishings, household equipment and routine maintenance of the house	67.9	-1.1	-1.2	-1.4	-1.6	-1.8	-2.1	-2.3	-2.6	-2.7	-2.8	-3.0	-3.0	-2.1
Health	14.3	13.7	14.2	14.8	15.4	16.3	16.4	17.4	17.5	17.5	16.9	16.3	16.4	16.1
Transport	101.4	4.7	5.2	5.8	5.5	4.5	3.8	3.5	3.8	4.3	4.0	3.7	3.6	4.4
Communications	22.5	7.9	8.9	8.8	9.0	7.5	7.4	7.4	7.4	7.3	7.3	7.3	7.2	7.8
Recreation and culture	95.5	8.5	9.6	8.5	7.7	7.1	7.0	12.5	14.3	6.1	6.3	6.2	6.1	8.3
Education	4.5	11.3	11.4	11.5	11.5	11.5	11.6	11.6	11.6	11.0	12.0	12.0	12.0	11.6
Hotels, cafés and restaurants	74.2	9.2	9.4	9.4	9.5	9.6	9.6	9.9	10.0	10.3	10.5	10.7	10.8	9.9
Miscellaneous goods and services	49.5	14.0	14.6	14.7	14.7	14.6	14.6	14.5	14.7	14.9	15.4	15.3	15.2	14.8
Total - 2004	1,000.0	12.1	12.3	12.4	12.4	12.9	13.1	13.5	13.5	12.6	13.2	13.1	13.2	12.9
Food and non-alcoholic beverages	197.6	7.4	7.1	7.2	7.5	7.1	7.1	6.3	5.4	4.7	4.7	4.8	6.6	6.3
Alcoholic beverages and tobacco	79.2	8.5	8.6	8.7	9.4	11.2	11.8	12.2	12.4	12.3	12.2	12.1	11.6	10.9
Clothing and footwear	56.9	-13.5	-14.3	-14.3	-14.2	-14.1	-14.1	-15.3	-16.1	-15.8	-14.8	-14.6	-14.6	-14.6
Housing, water, electricity, gas and other fuels	236.4	30.1	30.5	30.7	30.2	29.7	29.8	30.2	30.3	30.5	32.2	32.2	32.2	30.7
Furnishings, household equipment and routine maintenance of the house	67.9	-3.1	-3.3	-3.4	-3.4	-3.9	-3.9	-4.2	-4.4	-4.5	-4.6	-4.8	-4.9	-4.0
Health	14.3	16.5	17.0	17.4	17.9	20.3	20.7	20.9	21.2	21.7	21.0	20.6	20.6	19.7
Transport	101.4	5.8	5.8	6.8	6.8	8.2	7.6	7.3	7.2	6.4	7.0	6.6	5.0	6.7
Communications	22.5	24.2	23.1	23.0	22.9	21.5	21.4	21.3	19.7	19.6	21.2	21.1	21.0	21.7
Recreation and culture	95.5	7.4	8.7	7.6	7.0	7.5	9.1	14.9	17.0	8.9	8.4	8.0	7.9	9.4
Education	4.5	12.2	12.6	12.5	12.5	12.9	12.8	12.8	12.8	17.9	18.1	18.1	18.1	14.4
Hotels, cafés and restaurants	74.2	11.8	12.0	12.4	12.6	17.1	17.5	17.7	17.8	18.8	19.3	19.5	19.6	16.3
Miscellaneous goods and services	49.5	17.4	18.3	18.8	18.7	19.9	20.3	20.4	20.3	20.2	20.1	20.3	20.3	19.6
Total - 2005	1,000.0	14.0	14.2	14.1	14.2	14.4	15.1							14.3
Food and non-alcoholic beverages	197.6	6.9	6.9	6.8	6.6	7.3	7.5							7.0
Alcoholic beverages and tobacco	79.2	12.6	12.8	12.7	12.3	12.3	12.5							12.5
Clothing and footwear	56.9	-17.2	-18.2	-18.4	-18.1	-18.1	-18.3							-18.0
Housing, water, electricity, gas and other fuels	236.4	34.7	34.9	35.1	34.9	34.9	35.0							34.9
Furnishings, household equipment and routine maintenance of the house	67.9	-5.2	-5.4	-5.5	-5.7	-5.8	-5.9							-5.6
Health	14.3	25.5	26.1	26.7	27.3	29.1	30.1							27.5
Transport	101.4	3.9	3.7	4.1	6.8	6.9	7.8							5.5
Communications	22.5	21.0	20.1	20.1	20.0	19.9	38.6							23.3
Recreation and culture	95.5	9.8	11.4	10.1	8.9	9.4	10.1							10.0
Education	4.5	14.9	15.6	15.8	15.8	15.8	15.6							15.6
Hotels, cafés and restaurants	74.2	20.4	21.0	21.2	21.5	21.4	21.5							21.2
Miscellaneous goods and services	49.5	20.3	20.9	20.9	20.9	20.8	20.7							20.8

Source: CZSO

Table 3

CONSUMER PRICES – TRADABLES AND NONTRADABLES

percentage changes; December 1999 = 100

Group	Constant 1999 weights in per mille	2001 12	2002 12	2003 12	2004 6	2004 9	2004 12	2005 3	2005 6
1. Food and non-alcoholic beverages	197.6	7.9	2.1	5.7	7.1	4.7	6.6	6.8	7.5
- tradables	197.6	7.9	2.1	5.7	7.1	4.7	6.6	6.8	7.5
2. Alcoholic beverages and tobacco	79.2	5.4	7.1	7.8	11.8	12.3	11.6	12.7	12.5
- tradables	79.2	5.4	7.1	7.8	11.8	12.3	11.6	12.7	12.5
3. Clothing and footwear	56.9	-3.9	-7.7	-11.9	-14.1	-15.8	-14.6	-18.4	-18.3
- nontradables	1.4	13.0	18.3	21.1	34.4	34.9	35.9	36.9	37.1
- tradables	55.5	-4.3	-8.4	-12.7	-15.3	-17.1	-15.9	-19.8	-19.7
4. Housing, water, electricity, gas and other fuels	236.4	19.0	24.3	26.6	29.8	30.5	32.2	35.1	35.0
- nontradables	226.1	19.7	25.2	27.5	30.8	31.4	33.2	36.2	36.1
- tradables	10.3	2.7	4.0	5.9	8.5	11.3	10.7	11.9	10.6
5. Furnishings, household equipment and routine maintenance of the house	67.9	-0.4	-1.0	-3.0	-3.9	-4.5	-4.9	-5.5	-5.9
- nontradables	2.9	7.5	9.9	12.3	16.2	16.2	16.8	15.7	16.5
- tradables	65.0	-0.8	-1.5	-3.7	-4.8	-5.4	-5.9	-6.5	-6.9
6. Health	14.3	8.4	12.8	16.4	20.7	21.7	20.6	26.7	30.1
- nontradables	11.0	10.1	15.4	19.9	25.3	26.7	25.2	33.2	37.4
- tradables	3.3	2.7	4.4	5.1	5.7	5.5	5.6	5.7	6.4
7. Transport	101.4	3.4	4.1	3.6	7.6	6.4	5.0	4.1	7.8
- nontradables	27.4	11.7	16.0	18.4	22.7	22.9	23.0	24.4	24.7
- tradables	74.0	0.3	-0.3	-1.9	2.0	0.3	-1.6	-3.4	1.5
8. Communications	22.5	5.7	8.2	7.2	21.4	19.6	21.0	20.1	38.6
- nontradables	21.0	8.5	2.1	2.3	16.6	14.9	16.6	15.8	46.8
- tradables	1.5	-34.7	95.9	77.5	89.8	86.7	83.6	82.0	-79.0
9. Recreation and culture	95.5	7.2	7.2	6.1	9.1	8.9	7.9	10.1	10.1
- nontradables	60.4	14.3	16.2	16.7	22.4	22.7	21.2	25.0	26.2
- tradables	35.1	-5.0	-8.3	-12.1	-13.7	-14.8	-15.0	-15.5	-17.7
10. Education	4.5	6.8	11.3	12.0	12.8	17.9	18.1	15.8	15.6
- nontradables	4.5	6.8	11.3	12.0	12.8	17.9	18.1	15.8	15.6
11. Hotels, cafés and restaurants	74.2	5.9	8.7	10.8	17.5	18.8	19.6	21.2	21.5
- nontradables	74.2	5.9	8.7	10.8	17.5	18.8	19.6	21.2	21.5
12. Miscellaneous goods and services	49.5	8.7	11.9	15.2	20.3	20.2	20.3	20.9	20.7
- nontradables	22.0	17.5	25.8	36.4	47.7	48.1	48.4	50.3	50.7
- tradables	27.5	1.7	0.8	-1.7	-1.5	-2.0	-2.2	-2.6	-3.2
Household consumer prices, total	1,000.0	8.4	9.0	10.1	13.1	12.6	13.2	14.1	15.0
Tradables	549.1	2.9	0.6	0.7	1.9	0.6	0.9	0.4	0.6
- food	276.8	7.2	3.5	6.3	8.4	6.9	8.0	8.5	8.9
- others	272.3	-1.5	-2.4	-5.0	-4.8	-5.8	-6.3	-7.8	-7.8
Nontradables	450.9	15.2	19.2	21.6	26.7	27.3	28.2	30.8	32.6
- others	271.2	11.5	16.5	19.4	25.7	26.7	26.9	28.9	29.5
- regulated	179.7	20.6	23.2	24.9	28.3	28.2	30.3	33.7	37.3

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
1/01	4.5	—	—
2/01	4.3	—	—
3/01	4.2	4.2	4.0
4/01	4.0	—	—
5/01	4.3	—	—
6/01	4.6	4.8	5.1
7/01	4.6	—	—
8/01	4.7	—	—
9/01	4.8	4.7	4.9
10/01	4.4	—	—
11/01	4.0	—	—
12/01	3.9	3.9	4.6
1/02	3.8	—	—
2/02	3.5	—	—
3/02	3.5	3.6	3.9
4/02	3.5	—	—
5/02	3.3	—	—
6/02	3.1	2.7	1.6
7/02	2.8	—	—
8/02	2.7	—	—
9/02	3.1	2.4	1.3
10/02	2.5	—	—
11/02	2.4	—	—
12/02	2.3	2.3	2.3
1/03	2.5	—	—
2/03	2.4	—	—
3/03	2.5	2.1	4.3
4/03	2.6	—	—
5/03	3.7	—	—
6/03	3.2	2.6	1.7
7/03	3.3	—	—
8/03	3.2	—	—
9/03	3.1	2.6	3.1
10/03	3.0	—	—
11/03	3.1	—	—
12/03	3.3	2.9	4.2
1/04	2.9	—	—
2/04	3.2	—	—
3/04	3.0	3.3	4.9
4/04	2.8	—	—
5/04	2.6	—	—
6/04	2.7	3.1	4.9
7/04	2.8	—	—
8/04	2.8	—	—
9/04	3.0	3.1	1.7
10/04	2.8	—	—
11/04	2.8	—	—
12/04	2.8	3.2	1.5
1/05	2.8	—	—
2/05	2.6	—	—
3/05	2.6	2.7	3.8
4/05	2.5	—	—
5/05	2.4	—	—
6/05	2.3	2.7	4.2

Source: CNB statistical survey

Table 5

HARMONISED INDEX OF CONSUMER PRICES annual percentage changes

	2001 12	2002 12	2003 12	2004 12	2005 6
Belgium	2.0	1.3	1.7	1.9	2.7
Denmark	2.1	2.6	1.2	1.0	1.7
Finland	2.3	1.7	1.2	0.1	1.0
France	1.4	2.2	2.4	2.3	1.8
Ireland	4.4	4.6	2.9	2.4	1.9
Italy	2.2	3.0	2.5	2.4	2.2
Luxembourg	0.9	2.8	2.4	3.5	3.2
Germany	1.4	1.1	1.1	2.2	1.8
Netherlands	5.1	3.2	1.6	1.2	1.5
Portugal	3.9	4.0	2.3	2.6	0.6
Austria	1.8	1.7	1.3	2.5	2.0
Greece	3.5	3.5	3.1	3.1	3.2
Spain	2.5	4.0	2.7	3.3	3.2
Sweden	3.2	1.7	1.8	0.9	0.8
United Kingdom	1.0	1.7	1.3	1.6	2.0
European Union	1.9	2.2	1.8	2.2	2.0
Czech Republic	3.9	0.1	1.0	2.5	1.3

Source: Eurostat

Table 6

MONETARY SURVEY position at month-end in CZK billions

	2001 12	2002 12	2003 12	2004 12	2005 5
Total assets	1,596.0	1,651.8	1,766.1	1,844.1	1,911.9
Net external assets (NEAs)	800.6	926.1	821.5	863.3	993.3
NEAs of CNB	__	715.6	687.5	634.1	664.0
NEAs of OMFIs	__	210.5	134.0	229.3	329.3
Net domestic assets	795.4	725.8	944.5	980.8	918.6
Domestic loans	1,011.9	940.0	1,145.6	1,147.0	1,179.2
Net credit to government (NCG) (including securities)	__	215.8	354.0	257.5	228.5
NCG to central government (including securities)	__	260.4	408.7	312.4	293.7
NCG to other government (including securities)	__	-44.6	-54.8	-54.9	-65.2
Loans to corporations and households (excluding securities)	775.4	724.2	791.6	889.4	950.7
Loans to corporations (excluding securities)	636.1	542.7	554.1	574.2	606.3
Loans to households (excluding securities)	139.3	181.5	237.5	315.2	344.4
Other net items (including securities and capital)	-216.5	-214.3	-201.1	-166.2	-260.7
Holdings of securities	__	18.5	16.6	18.8	18.7
Issued securities	__	-48.6	-51.6	-75.0	-95.4
Liabilities					
Monetary aggregate M2	1,596.0	1,651.8	1,766.1	1,844.1	1,911.9
Monetary aggregate M1	583.6	787.7	902.8	962.3	1,007.7
Currency in circulation	180.4	197.8	221.4	236.8	248.7
Overnight deposits	__	589.9	681.4	725.6	759.0
Overnight deposits - households	__	315.6	372.1	410.8	443.6
Overnight deposits - corporations	__	274.3	309.3	314.7	315.3
M2-M1 (quasi money)	1,012.4	864.1	863.3	881.8	904.2
Deposits with agreed maturity	__	651.2	666.4	675.4	695.9
Deposits with agreed maturity - households	__	448.6	439.8	458.6	461.2
Deposits with agreed maturity - corporations	__	202.5	226.6	216.7	234.7
Deposits redeemable at notice	__	194.3	185.6	198.8	198.7
Deposits redeemable at notice - households	__	190.7	182.3	194.6	194.3
Deposits redeemable at notice - corporation	__	3.6	3.2	4.2	4.5
Repurchase agreements	__	18.6	11.3	7.6	9.5
Annual percentage changes					
M1	17.3	35.0	14.6	6.6	7.6
M2	13.0	3.5	6.9	4.4	5.4
Loans to corporations and households	-19.6	-6.6	9.3	12.4	16.4
M2-M1 (deposits)	10.7	-14.6	-0.1	2.1	3.0
Annual percentage growth rates					
M1	__	__	15.5	8.3	8.1
M2	__	__	8.1	5.8	5.9
Loans to corporations and households	__	__	11.8	15.3	17.8
M2-M1 (deposits)	__	__	1.2	3.3	3.5

Table 7

INTEREST RATES ON INTERBANK DEPOSITS percentages

	2001 12	2002 12	2003 12	2004 12	2005 6
1. Average PRIBOR [1]					
- 1 day	4.63	2.75	1.98	2.49	1.75
- 7 day	4.79	2.76	2.02	2.51	1.75
- 14 day	4.78	2.76	2.03	2.51	1.75
- 1 month	4.77	2.73	2.04	2.53	1.75
- 2 month	4.72	2.67	2.06	2.55	1.75
- 3 month	4.69	2.63	2.08	2.57	1.75
- 6 month	4.62	2.60	2.13	2.67	1.75
- 9 month	4.61	2.60	2.22	2.76	1.75
- 12 month	4.62	2.60	2.30	2.85	1.75
2. Average PRIBID [1]					
- 1 day	4.53	2.65	1.88	2.39	1.65
- 7 day	4.69	2.67	1.92	2.41	1.65
- 14 day	4.69	2.67	1.93	2.41	1.65
- 1 month	4.68	2.64	1.94	2.43	1.65
- 2 month	4.62	2.57	1.96	2.45	1.65
- 3 month	4.59	2.54	1.98	2.47	1.65
- 6 month	4.52	2.51	2.03	2.57	1.65
- 9 month	4.52	2.51	2.12	2.66	1.65
- 12 month	4.52	2.51	2.20	2.75	1.65

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

Table 8

FRA RATES

percentages; monthly averages

	2001 12	2002 12	2003 12	2004 12	2005 6
3 * 6	4.49	2.52	2.23	2.74	1.68
3 * 9	4.53	2.54	2.36	2.81	1.69
6 * 9	4.53	2.52	2.47	2.85	1.69
6 * 12	4.52	2.58	2.64	2.92	1.73
9 * 12	4.54	2.61	2.77	2.97	1.77
9*12 - 3*6 spread	0.05	0.10	0.55	0.24	0.09
6*12 - 3*9 spread	-0.02	0.04	0.28	0.12	0.04

IRS RATES

percentages; monthly averages

	2001 12	2002 12	2003 12	2004 12	2005 6
1Y	4.64	2.63	2.41	2.82	1.72
2Y	4.72	2.85	2.98	3.06	1.94
3Y	4.89	3.18	3.38	3.27	2.19
4Y	5.05	3.46	3.69	3.45	2.42
5Y	5.19	3.70	3.93	3.62	2.62
6Y	5.32	3.91	4.13	3.77	2.78
7Y	5.43	4.08	4.29	3.89	2.93
8Y	5.52	4.23	4.43	4.00	3.06
9Y	5.60	4.36	4.54	4.09	3.17
10Y	5.66	4.47	4.64	4.17	3.27
15Y	5.85	4.77	4.97	4.40	3.55
20Y	—	—	5.11	4.54	3.72
5Y - 1Y spread	0.56	1.07	1.52	0.80	0.90
10Y - 1Y spread	1.02	1.84	2.23	1.35	1.55

Table 9

NOMINAL AND REAL INTEREST RATES (ex post approach)

percentages

	Nominal rates				Real rates based on CPI				Real rates based on PPI		
	PRIBOR		client rates		PRIBOR		client rates		PRIBOR		new client loans
	2W	1Y	new loans	time deposits	2W	1Y	new loans	time deposits	2W	1Y	
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	1.5	-0.5	-0.2	2.6	-1.0	-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	1.6	-0.8	-0.1	2.4	-1.3	-3.9	-3.2	-0.8
7/04	2.3	3.0	5.7	1.7	-0.9	-0.2	2.4	-1.5	-4.7	-4.0	-1.5
8/04	2.3	3.0	6.0	1.7	-1.0	-0.4	2.5	-1.7	-5.3	-4.7	-1.9
9/04	2.5	3.1	5.9	1.8	-0.5	0.1	2.9	-1.2	-5.1	-4.5	-1.9
10/04	2.5	3.0	6.0	1.8	-1.0	-0.4	2.4	-1.6	-5.6	-5.1	-2.4
11/04	2.5	2.9	6.1	1.8	-0.4	0.0	3.1	-1.1	-5.3	-4.9	-2.0
12/04	2.5	2.8	6.1	1.9	-0.3	0.0	3.2	-0.9	-4.8	-4.5	-1.5
1/05	2.5	2.7	6.2	1.8	0.8	1.0	4.4	0.1	-4.4	-4.2	-1.0
2/05	2.3	2.2	6.0	1.7	0.6	0.5	4.2	0.0	-4.5	-4.5	-1.1
3/05	2.2	2.1	5.6	1.7	0.7	0.6	4.1	0.2	-3.9	-4.0	-0.7
4/05	2.0	2.1	5.9	1.6	0.4	0.4	4.2	0.0	-3.4	-3.4	0.2
5/05	1.8	1.8	5.8	1.4	0.5	0.5	4.5	0.1	-2.1	-2.1	1.7
6/05	1.8	1.8	__	__	0.0	0.0	__	__	-0.9	-0.9	__

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

Table 10

REAL INTEREST RATES (ex ante approach)

percentages

	Real rates expected by financial markets				Real rates expected by businesses				Real rates expected by households			
	PRIBOR		client rates		PRIBOR		client rates		PRIBOR		client rates	
	2W	1Y	new loans	time deposits	2W	1Y	new loans	time deposits	2W	1Y	new loans	time deposits
1/01	0.8	1.1	1.8	-0.6	—	—	—	—	—	—	—	—
2/01	0.9	1.0	1.8	-0.4	—	—	—	—	—	—	—	—
3/01	0.8	0.8	1.9	-0.4	0.8	0.8	1.9	-0.4	1.0	1.0	2.1	-0.3
4/01	1.0	0.9	2.1	-0.3	—	—	—	—	—	—	—	—
5/01	0.7	0.7	1.9	-0.6	—	—	—	—	—	—	—	—
6/01	0.4	0.7	1.6	-0.8	0.2	0.5	1.4	-1.0	-0.1	0.2	1.1	-1.3
7/01	0.5	1.0	1.7	-0.8	—	—	—	—	—	—	—	—
8/01	0.6	1.2	1.8	-0.9	—	—	—	—	—	—	—	—
9/01	0.5	0.8	1.7	-1.0	0.5	0.8	1.7	-1.0	0.4	0.7	1.6	-1.1
10/01	0.9	0.9	2.1	-0.7	—	—	—	—	—	—	—	—
11/01	1.2	0.9	2.2	-0.4	—	—	—	—	—	—	—	—
12/01	0.9	0.7	1.9	-0.6	0.9	0.7	1.9	-0.6	0.2	0.0	1.2	-1.2
1/02	0.9	0.7	1.9	-0.5	—	—	—	—	—	—	—	—
2/02	0.8	0.8	1.5	-0.4	—	—	—	—	—	—	—	—
3/02	0.8	1.0	1.8	-0.5	0.7	0.9	1.7	-0.6	0.4	0.6	1.4	-0.9
4/02	0.7	0.8	1.5	-0.5	—	—	—	—	—	—	—	—
5/02	0.5	0.7	1.5	-0.5	—	—	—	—	—	—	—	—
6/02	0.7	0.8	1.9	-0.2	1.1	1.2	2.3	0.2	2.2	2.3	3.4	1.3
7/02	0.7	0.6	1.7	0.0	—	—	—	—	—	—	—	—
8/02	0.3	0.4	1.7	-0.4	—	—	—	—	—	—	—	—
9/02	-0.1	-0.1	1.4	-0.6	1.1	1.0	2.6	0.6	1.7	1.6	3.2	1.2
10/02	0.5	0.3	2.0	-0.2	—	—	—	—	—	—	—	—
11/02	0.4	0.3	1.8	-0.3	—	—	—	—	—	—	—	—
12/02	0.5	0.3	1.9	-0.1	0.5	0.3	1.9	-0.1	0.5	0.3	1.9	-0.1
1/03	0.2	0.1	1.6	-0.3	—	—	—	—	—	—	—	—
2/03	0.1	0.0	1.4	-0.3	—	—	—	—	—	—	—	—
3/03	0.0	-0.1	1.3	-0.4	0.4	0.3	1.7	-0.1	-1.7	-1.9	-0.4	-2.2
4/03	-0.1	-0.2	1.3	-0.6	—	—	—	—	—	—	—	—
5/03	-1.2	-1.2	0.3	-1.6	—	—	—	—	—	—	—	—
6/03	-0.7	-0.9	0.6	-1.2	-0.1	-0.3	1.2	-0.6	0.8	0.6	2.1	0.2
7/03	-1.0	-1.0	0.2	-1.5	—	—	—	—	—	—	—	—
8/03	-1.1	-1.1	0.1	-1.4	—	—	—	—	—	—	—	—
9/03	-1.0	-0.9	0.5	-1.3	-0.6	-0.4	1.0	-0.8	-1.0	-0.9	0.5	-1.3
10/03	-0.9	-0.8	0.6	-1.2	—	—	—	—	—	—	—	—
11/03	-1.0	-0.8	0.4	-1.3	—	—	—	—	—	—	—	—
12/03	-1.2	-1.0	0.4	-1.5	-0.8	-0.6	0.7	-1.1	-2.1	-1.8	-0.5	-2.4
1/04	-0.9	-0.6	2.5	-1.4	—	—	—	—	—	—	—	—
2/04	-1.2	-0.8	1.8	-1.7	—	—	—	—	—	—	—	—
3/04	-1.0	-0.7	2.1	-1.5	-1.2	-1.0	1.8	-1.8	-2.8	-2.5	0.2	-3.3
4/04	-0.8	-0.5	2.5	-1.3	—	—	—	—	—	—	—	—
5/04	-0.6	-0.1	2.7	-1.1	—	—	—	—	—	—	—	—
6/04	-0.6	0.1	2.6	-1.1	-1.0	-0.3	2.2	-1.5	-2.7	-2.0	0.4	-3.2
7/04	-0.5	0.2	2.8	-1.1	—	—	—	—	—	—	—	—
8/04	-0.5	0.2	3.1	-1.1	—	—	—	—	—	—	—	—
9/04	-0.5	0.1	2.9	-1.2	-0.6	0.0	2.8	-1.3	0.8	1.4	4.2	0.1
10/04	-0.3	0.2	3.1	-1.0	—	—	—	—	—	—	—	—
11/04	-0.3	0.1	3.2	-1.0	—	—	—	—	—	—	—	—
12/04	-0.3	0.0	3.2	-0.9	-0.7	-0.3	2.8	-1.3	1.0	1.3	4.5	0.3
1/05	-0.3	-0.1	3.3	-0.9	—	—	—	—	—	—	—	—
2/05	-0.3	-0.3	3.3	-0.8	—	—	—	—	—	—	—	—
3/05	-0.4	-0.5	2.9	-0.9	-0.5	-0.6	2.8	-1.0	-1.5	-1.6	1.8	-2.0
4/05	-0.5	-0.4	3.3	-0.9	—	—	—	—	—	—	—	—
5/05	-0.6	-0.6	3.3	-0.9	—	—	—	—	—	—	—	—
6/05	-0.5	-0.5	—	—	-0.9	-0.9	—	—	-2.3	-2.3	—	—

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

	2001 12	2002 12	2003 12	2004 12	2005 5
Koruna interest rates on loans provided by banks to residents:					
Households and non-profit institutions serving households (S.14+S.15) - total	8.74	8.77	8.24	7.96	7.64
- maturity up to 1 year	8.20	10.35	11.21	12.81	13.44
- maturity over 1 year and up to 5 years	10.55	10.80	10.17	12.40	11.95
- maturity over 5 years	8.02	7.35	6.65	6.39	6.23
for consumption - total	__	13.83	13.83	14.89	14.45
- maturity up to 1 year	__	13.05	14.26	15.48	16.25
- maturity over 1 year and up to 5 years	__	14.48	13.86	15.17	15.14
- maturity over 5 years	__	12.55	13.21	13.45	12.19
for house purchase - total	__	7.11	6.31	5.93	5.67
- maturity up to 1 year	__	7.67	6.24	4.48	4.38
- maturity over 1 year and up to 5 years	__	7.90	7.05	6.57	6.23
- maturity over 5 years	__	6.88	6.09	5.89	5.64
other - total	__	6.99	7.80	7.50	7.22
- maturity up to 1 year	__	6.64	8.49	8.96	9.21
- maturity over 1 year and up to 5 years	__	6.34	8.02	7.63	7.05
- maturity over 5 years	__	7.61	7.02	6.58	6.27
Non-financial corporations (S.11) - total	6.84	5.19	4.53	4.75	4.26
- maturity up to 1 year	6.32	4.34	4.08	4.35	3.85
- maturity over 1 year and up to 5 years	6.93	5.47	4.64	4.68	4.15
- maturity over 5 years	7.52	6.34	5.14	5.39	4.94
Koruna interest rates on deposits accepted by banks from residents:					
Households and non-profit institutions serving households (S.14+S.15) - total	2.63	1.72	1.30	1.41	1.20
overnight	1.42	0.94	0.50	0.52	0.38
with agreed maturity - total	3.11	2.26	2.02	2.13	1.91
- with agreed maturity up to 2 years	__	1.68	0.96	1.37	0.87
- with agreed maturity over 2 years	__	3.04	2.90	2.69	2.61
redeemable at notice - total	__	1.81	1.26	1.63	1.46
- redeemable at notice up to 3 months	__	1.93	1.67	2.14	2.06
- redeemable at notice over 3 months	__	1.73	0.98	1.12	0.76
Non-financial corporations (S.11) - total	1.96	1.25	0.85	1.21	0.92
overnight	1.00	0.94	0.64	0.68	0.53
with agreed maturity - total	3.62	2.16	1.50	2.08	1.46
- with agreed maturity up to 2 years	__	2.15	1.49	2.05	1.43
- with agreed maturity over 2 years	__	3.47	3.04	3.12	2.58
redeemable at notice - total	__	1.64	1.17	1.60	1.06
- redeemable at notice up to 3 months	__	1.60	1.14	1.49	0.96
- redeemable at notice over 3 months	__	2.26	1.32	2.26	1.70

Table 12

BALANCE OF PAYMENTS [1]

in CZK millions

	2001 Q1 - 4	2002 Q1 - 4	2003 Q1 - 4	2004 [2] Q1 - 4	2005 [2] Q1
A. Current account	-124,478.3	-136,378.1	-160,614.6	-143,259.0	14,564.8
Balance of trade [3]	-116,685.0	-71,323.0	-69,793.0	-22,325.0	19,360.0
exports	1,269,634.0	1,254,394.0	1,370,930.0	1,713,694.0	438,920.0
imports	1,386,319.0	1,325,717.0	1,440,723.0	1,736,019.0	419,560.0
Services	57,984.9	21,850.8	13,236.7	12,472.5	1,675.4
credit	269,689.6	231,131.1	219,151.1	248,433.1	57,289.5
transport	57,492.3	56,560.5	60,556.3	72,308.9	17,521.1
travel	118,133.0	96,289.2	100,310.1	107,129.8	22,217.8
others	94,064.3	78,281.4	58,284.7	68,994.4	17,550.6
debit	211,704.7	209,280.3	205,914.4	235,960.6	55,614.1
transport	30,570.5	29,332.8	33,725.7	38,603.0	8,722.8
travel	52,802.0	51,549.3	54,419.2	58,362.8	11,072.4
others	128,332.2	128,398.2	117,769.5	138,994.8	35,818.9
Income	-83,548.9	-115,615.0	-119,858.4	-139,535.9	-18,125.0
credit	84,892.3	66,790.1	75,508.3	70,209.1	21,595.9
debit	168,441.2	182,405.1	195,366.7	209,745.0	39,720.9
Current transfers	17,770.7	28,709.1	15,800.1	6,129.4	11,654.4
credit	36,404.9	46,709.0	46,976.7	46,045.3	26,413.0
debit	18,634.2	17,999.9	31,176.6	39,915.9	14,758.6
B. Capital account	-330.7	-119.4	-82.2	-14,017.0	1,435.4
credit	90.4	221.0	198.2	5,608.2	1,519.1
debit	421.1	340.4	280.4	19,625.2	83.7
Total A + B	-124,809.0	-136,497.5	-160,696.8	-157,276.0	16,000.2
C. Financial account	172,849.9	347,827.4	157,093.5	180,923.0	-14,892.8
Direct investment	208,296.1	270,930.2	53,500.3	100,673.6	28,613.0
abroad	-6,289.2	-6,759.3	-5,815.7	-14,038.9	-864.2
equity capital and reinvested earnings	-5,848.5	-5,376.8	-3,124.6	-12,732.3	-1,041.7
other capital	-440.7	-1,382.5	-2,691.1	-1,306.6	177.5
in the Czech Republic	214,585.3	277,689.5	59,316.0	114,712.5	29,477.2
equity capital and reinvested earnings	185,981.4	270,061.0	59,350.4	104,432.3	29,275.9
other capital	28,603.9	7,628.5	-34.4	10,280.2	201.3
Portfolio investment	34,857.3	-46,748.7	-35,719.1	62,209.2	-20,532.9
assets	4,405.6	-75,602.1	-83,892.7	-61,068.5	-31,436.2
equity securities	9,447.8	-7,807.9	5,630.5	-27,280.4	-6,533.0
debt securities	-5,042.2	-67,794.2	-89,523.2	-33,788.1	-24,903.2
liabilities	30,451.7	28,853.4	48,173.6	123,277.7	10,903.3
equity securities	23,203.6	-9,035.7	30,133.5	19,558.6	-17,127.8
debt securities	7,248.1	37,889.1	18,040.1	103,719.1	28,031.1
Financial derivatives	-3,220.3	-4,281.7	3,860.1	-1,539.7	-533.0
assets	-9,407.6	-15,458.4	7,083.7	-13,902.7	-2,842.9
liabilities	6,187.3	11,176.7	-3,223.6	12,363.0	2,309.9
Other investment	-67,083.2	127,927.6	135,452.2	19,579.9	-22,439.9
assets	-46,144.5	133,121.8	67,071.3	-35,983.8	-8,585.4
long-term	1,325.8	28,711.4	1,141.3	20,516.9	1,284.2
CNB	—	—	—	-184.9	—
commercial banks	-4,125.8	5,271.7	-999.9	587.7	650.3
government	6,928.9	25,333.6	5,714.3	22,790.7	1,000.6
other sectors	-1,477.3	-1,893.9	-3,573.1	-2,676.6	-366.7
short-term	-47,470.3	104,410.4	65,930.0	-56,500.7	-9,869.6
commercial banks	-45,523.2	122,163.8	44,971.2	-34,807.6	-1,155.6
government	-87.1	-2,237.4	2,193.8	92.9	—
other sectors	-1,860.0	-15,516.0	18,765.0	-21,786.0	-8,714.0
liabilities	-20,938.7	-5,194.2	68,380.9	55,563.7	-13,854.5
long-term	-4,262.6	2,853.8	26,361.6	29,813.4	-4,022.7
CNB	-22.0	-20.2	-20.4	-20.5	-9.7
commercial banks	-7,222.2	-8,059.2	-5,038.0	-1,410.8	-1,529.8
government	-5,000.8	-1,517.2	10,304.7	9,264.7	833.8
other sectors	7,982.4	12,450.4	21,115.3	21,980.0	-3,317.0
short-term	-16,676.1	-8,048.0	42,019.3	25,750.3	-9,831.8
CNB	59.7	-24.3	-21.4	843.7	-512.8
commercial banks	-35,688.6	-3,871.2	37,899.4	-14,766.2	-21,386.8
government	—	—	—	—	—
other sectors	18,952.8	-4,152.5	4,141.3	39,672.8	12,067.8
Total A + B + C	48,040.9	211,329.9	-3,603.3	23,647.0	1,107.4
D. Net errors and omissions, valuation changes	19,112.1	5,615.1	16,506.7	-16,864.8	2,136.2
Total A + B + C + D	67,153.0	216,945.0	12,903.4	6,782.2	3,243.6
E. Change in reserves (- increase)	-67,153.0	-216,945.0	-12,903.4	-6,782.2	-3,243.6

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

	2001 31 Dec.	2002 31 Dec.	2003 31 Dec.	2004[1] 31 Dec.	2005[1] 31 Mar.
Assets	1,544,963.0	1,579,922.9	1,537,284.6	1,535,040.8	1,584,956.2
Direct investment abroad	41,176.1	44,397.1	58,581.5	68,450.0	69,205.0
- equity capital	37,633.6	39,472.1	50,965.5	60,050.0	61,045.0
- other capital	3,542.5	4,925.0	7,616.0	8,400.0	8,160.0
Portfolio investment	185,138.6	274,344.7	343,968.7	369,425.6	398,343.2
- equity securities	68,675.5	86,464.7	47,337.7	73,309.3	78,260.1
- debt securities	116,463.1	187,880.0	296,631.0	296,116.3	320,083.1
Financial derivatives	15,754.8	31,213.2	24,129.5	38,032.2	40,875.1
Other investment	778,435.7	515,356.2	419,090.0	422,891.5	440,326.2
Long-term	310,133.9	179,639.6	157,598.6	118,694.3	118,128.6
- CNB	307.3	280.9	468.4	600.0	599.9
- commercial banks	79,663.7	67,966.9	66,121.3	58,055.5	57,492.6
- government	210,694.9	97,156.8	79,483.9	48,918.8	48,156.1
- other sectors	19,468.0	14,235.0	11,525.0	11,120.0	11,880.0
Short-term	468,301.8	335,716.6	261,491.4	304,197.2	322,197.6
- CNB	51.2	376.7	98.8	71.7	57.3
- commercial banks	359,638.5	213,815.4	161,150.2	185,146.0	193,830.8
of which: gold and foreign exchange	257,138.6	163,032.9	115,884.8	128,118.7	128,194.3
- government	87.1	2,324.5	102.4	9.5	9.5
- other sectors	108,525.0	119,200.0	100,140.0	118,970.0	128,300.0
CNB reserves	524,457.8	714,611.7	691,514.9	636,241.5	636,206.7
- gold	4,469.9	4,653.8	4,784.3	4,253.9	4,325.2
- SDR	31.0	137.1	238.7	118.0	162.6
- reserve position in the IMF	5,478.3	7,081.5	11,949.9	9,137.5	8,647.7
- foreign exchange	514,188.0	686,516.1	674,451.8	622,606.4	623,009.5
- other reserve assets	290.6	16,223.2	90.2	125.7	61.7
Liabilities	1,789,030.7	1,977,177.7	2,064,768.3	2,360,031.1	2,409,824.7
Direct investment in the Czech Republic	982,335.0	1,165,529.1	1,161,783.6	1,261,710.9	1,290,836.8
- equity capital	837,537.3	1,013,102.9	1,009,391.8	1,106,150.9	1,135,426.8
- other capital	144,797.7	152,426.2	152,391.8	155,560.0	155,410.0
Portfolio investment	180,346.2	201,120.0	223,620.4	381,019.4	414,572.9
- equity securities	128,740.1	128,097.7	140,788.6	208,872.1	213,583.3
- debt securities	51,606.1	73,022.3	82,831.8	172,147.3	200,989.6
Financial derivatives	11,495.2	22,671.9	19,448.3	31,811.3	34,121.3
Other investment	614,854.3	587,856.7	659,916.0	685,489.5	670,293.7
Long-term	332,593.2	326,321.3	360,279.2	372,377.2	366,299.3
- CNB	133.4	114.5	96.1	70.2	58.1
- commercial banks	73,688.6	63,541.0	58,056.3	52,020.9	50,314.4
- government	9,476.2	9,475.8	22,456.0	32,065.4	32,716.1
- other sectors	249,295.0	253,190.0	279,670.8	288,220.7	283,210.7
Short-term	282,261.1	261,535.4	299,636.8	313,112.3	303,994.4
- CNB	68.5	44.2	22.8	866.5	353.7
- commercial banks	190,487.6	176,196.2	208,534.0	185,565.8	165,120.7
- government	—	—	—	—	—
- other sectors	91,705.0	85,295.0	91,080.0	126,680.0	138,520.0
Net investment position	-244,067.7	-397,254.8	-527,483.7	-824,990.3	-824,868.5

1) Preliminary data

Table 14

EXTERNAL DEBT					in CZK millions
	2001 31 Dec.	**2002 31 Dec.**	**2003 31 Dec.**	**2004[1] 31 Dec.**	**2005[1] 31 Mar.**
Debt in convertible currencies	811,258.1	813,305.2	895,139.6	1,013,196.8	1,026,693.3
of which:					
Long-term	465,687.8	498,833.8	535,995.9	631,667.2	656,606.5
By debtor					
- CNB	133.4	114.5	96.1	70.2	58.1
- commercial banks	88,401.4	80,063.7	73,276.4	64,346.6	62,664.8
- government	30,839.2	47,701.3	69,029.9	147,729.1	177,425.2
- other sectors	346,313.8	370,954.3	393,593.5	419,521.3	416,458.4
By creditor					
- foreign banks	229,305.5	230,589.8	251,535.3	263,931.4	257,371.3
- government institutions	2,373.6	1,747.2	—	—	—
- multilateral institutions	70,879.0	69,894.7	83,779.6	84,862.4	85,433.2
- suppliers and direct investors	105,944.3	118,829.4	109,287.9	108,720.0	108,520.0
- other investors	57,185.4	77,772.7	91,393.1	174,153.4	205,282.0
Short-term	345,570.3	314,471.4	359,143.7	381,529.6	370,086.8
By debtor					
- CNB	68.5	44.2	22.8	866.5	353.7
- commercial banks	192,438.4	177,474.4	210,017.0	189,036.5	166,968.9
- government	465.0	761.0	710.0	3,334.6	4,425.4
- other sectors	152,598.4	136,191.8	148,393.9	188,292.0	198,338.8
By creditor					
- foreign banks	192,126.4	168,200.7	218,436.1	208,032.3	197,143.0
- multilateral institutions	—	—	—	861.3	349.6
- suppliers and direct investors	116,278.4	112,256.8	105,563.9	130,000.0	133,330.0
- other investors	37,165.5	34,013.9	35,143.7	42,636.0	39,264.2
Debt in non-convertible currencies	—	—	—	—	—
of which:					
- long-term	—	—	—	—	—
- short-term	—	—	—	—	—
Total external debt	811,258.1	813,305.2	895,139.6	1,013,196.8	1,026,693.3
of which:					
- long-term	465,687.8	498,833.8	535,995.9	631,667.2	656,606.5
- short-term	345,570.3	314,471.4	359,143.7	381,529.6	370,086.8
Total long-term debt	465,687.8	498,833.8	535,995.9	631,667.2	656,606.5
of which:					
- IMF loans	—	—	—	—	—
- liabilities of government sector and guaranteed by government, and liabilities of entities majority owned by state	203,102.3	207,325.2	222,120.9	275,002.1	299,663.6
- liabilities of entities with majority private capital	262,585.5	291,508.6	313,875.0	356,665.1	356,942.9

1) Preliminary data

Table 15

EXCHANGE RATES

in CZK; foreign exchange market rates

A. NOMINAL RATE	2001 1 - 12	2002 1 - 12	2003 1 - 12	2004 1 - 12	2005 4 - 6
CZK exchange rate against selected currencies					
- annual/quarterly averages					
1 EUR	34.08	30.81	31.84	31.90	30.13
1 USD	38.04	32.74	28.23	25.70	23.94
100 SKK	78.68	72.22	76.75	79.69	77.40
	12	**12**	**12**	**12**	**6**
- monthly averages					
1 EUR	32.59	31.19	32.31	30.65	30.03
1 USD	36.48	30.65	26.32	22.87	24.69
100 SKK	75.61	74.67	78.57	78.81	77.91
	31 Dec.	**31 Dec.**	**31 Dec.**	**31 Dec.**	**30 Jun.**
- last day of the month					
1 EUR	31.98	31.60	32.41	30.47	30.03
1 USD	36.26	30.14	25.65	22.37	24.84
100 SKK	74.81	75.18	78.71	78.63	78.18

B. NOMINAL EFFECTIVE RATE	2001	2002	2003	2004	2005 6
CZK nominal effective exchange rate (percentages)					
(2000=100)					
weights - foreign trade turnover	104.3	116.5	116.0	116.3	122.1
weights - foreign trade turnover SITC 5-8	104.4	116.1	115.6	115.5	121.4

Drawing on CZSO statistics on the geographical and commodity structure of foreign trade for 2000, 23 countries which account for around 90% of the Czech Republic's foreign trade were selected. The weights were processed in two alternatives:
Alternative I, used by the IMF, applies to the Czech Republic's entire foreign trade turnover
Alternative II, used by the European Central Bank, applies to only four commodity groups of the Czech Republic's foreign trade

C. REAL EFFECTIVE RATE	2001	2002	2003	2004	2005 5
CZK real effective exchange rate (percentages)					
(2000=100)					
a) industrial producer prices					
weights - foreign trade turnover	104.3	115.2	111.3	114.0	118.3
weights - foreign trade turnover SITC 5-8	104.9	115.9	112.0	115.4	120.5
b) consumer prices					
weights - foreign trade turnover	105.5	116.7	112.9	113.0	117.3
weights - foreign trade turnover SITC 5-8	106.2	117.5	113.7	114.1	118.9

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

Table 16

PUBLIC FINANCES					in CZK billions
	2001	**2002**	**2003**	**2004**	**2005**
	1 - 12	**1 - 12**	**1 - 12**	**1 - 12**	**1 - 6**
STATE BUDGET					
Total revenue	626.2	705.0	699.7	769.2	426.3
Tax revenue	598.3	627.4	667.5	716.7	374.5
Taxes on income, profits and capital gains	147.4	159.0	172.9	180.7	99.3
Domestic taxes on goods and services	187.0	186.9	198.4	223.2	118.3
- value-added taxes	121.3	118.1	125.6	140.4	64.0
- excises	65.7	68.9	72.9	82.8	54.3
Taxes on property	6.4	7.9	8.8	10.4	4.1
Social and health security contributions and payroll taxes	242.3	258.5	272.4	293.3	149.8
Non-tax and capital incomes and received subsidies	27.9	77.7	32.2	52.5	51.7
Total expenditure	693.9	750.8	808.7	862.9	422.5
Current expenditure	642.5	697.3	745.4	796.8	401.2
Capital expenditure	51.4	53.5	63.3	66.1	21.3
Public budgets (balance in IMF GFS methodology)	-48.8	-11.5	-129.4	-90.4	—
state budget	-63.3	-45.7	-106.6	-65.0	3.8
local budget	-11.2	-4.3	-2.9	-8.9	—
state financial assets	—	—	—	—	—
state funds	-1.7	12.3	6.9	-10.7	—
Land Fund	-0.1	-0.5	-0.1	-4.2	—
National Property Fund	26.1	28.4	-27.4	-1.8	—
health insurance companies	1.4	-1.2	0.1	0.2	—
others	0.0	-0.5	0.6	0.0	—

1) Excluding the effect of reserve funds (methodical revision of the Ministry of Finance of the Czech Republic)

Table 17

CAPITAL MARKET

last day of the month in points

A. STOCK MARKET INDICES	2001 12	2002 12	2003 12	2004 12	2005 6
BCPP					
PX 50	394.6	460.7	659.1	1,032.0	1,210.1
PX-D	1,065.6	1,166.4	1,642.7	2,551.1	2,964.1
PX-GLOB	492.9	576.8	816.9	1,232.7	1,449.5
RM-SYSTÉM					
PK-30	593.0	672.5	947.5	1,443.5	1,721.4

in CZK millions

B. TRADE VOLUMES	2001 12	2002 12	2003 12	2004 12	2005 6
BCPP					
Monthly trade volumes	142,803.6	109,264.8	98,640.0	90,610.5	104,515.5
of which:					
a) shares	12,819.3	17,089.3	28,296.0	46,210.3	65,685.4
b) units	4.3	0.0	0.0	0.0	0.0
c) bonds	129,980.0	92,175.5	70,344.0	44,400.2	38,830.1
RM-SYSTÉM					
Monthly trade volumes	2,162.5	4,412.1	1,103.0	335.8	1,974.5
of which:					
a) shares	1,841.0	298.4	1,082.5	332.7	1,049.6
b) units	212.2	1.0	3.7	3.1	5.1
c) bonds	109.3	4,112.7	16.8	0.0	919.8

Table 18

CNB MONETARY POLICY INSTRUMENTS

	2W repo rate (%)	Discount rate (%)	Lombard rate (%)	Minimum reserve requirement for primary deposits (%)	
				Banks	Building societies and ČMZRB
1999					
18 January	8.75	—	—	—	—
28 January	—	—	—	5.00	—
29 January	8.00	—	—	—	—
12 March	7.50	6.00	10.00	—	—
9 April	7.20	—	—	—	—
4 May	6.90	—	—	—	—
25 June	6.50	—	—	—	—
30 July	6.25	—	—	—	—
3 September	6.00	5.50	8.00	—	—
5 October	5.75	—	—	—	—
7 October	—	—	—	2.00	2.00
27 October	5.50	5.00	7.50	—	—
26 November	5.25	—	—	—	—
2000	No changes made				
2001					
23 February	5.00	4.00	6.00	—	—
27 July	5.25	4.25	6.25	—	—
30 November	4.75	3.75	5.75	—	—
2002					
22 January	4.50	3.50	5.50	—	—
1 February	4.25	3.25	5.25	—	—
26 April	3.75	2.75	4.75	—	—
26 July	3.00	2.00	4.00	—	—
1 November	2.75	1.75	3.75	—	—
2003					
31 January	2.50	1.50	3.50	—	—
26 June	2.25	1.25	3.25	—	—
1 August	2.00	1.00	3.00	—	—
2004					
25 June	2.25	1.25	3.25	—	—
27 August	2.50	1.50	3.50	—	—
2005					
28 January	2.25	1.25	3.25	—	—
1 April	2.00	1.00	3.00	—	—
29 April	1.75	0.75	2.75	—	—

Table 19

MACROECONOMIC AGGREGATES

in CZK millions; annual percentage changes; constant 1995 prices

	2001 Q1 - 4	2002 Q1 - 4	2003 Q1 - 4	2004 Q1 - 4	2005 Q1
GROSS DOMESTIC PRODUCT					
- in CZK millions	1,617,894	1,641,996	1,694,684	1,769,936	439,064
- percentages	2.6	1.5	3.2	4.4	4.4
FINAL CONSUMPTION					
- in CZK millions	1,215,582	1,255,918	1,310,914	1,321,457	310,711
- percentages	3.0	3.3	4.4	0.8	-0.2
of which:					
Households					
- in CZK millions	851,305	874,649	915,270	933,555	221,512
- percentages	2.8	2.7	4.6	2.0	1.3
Government					
- in CZK millions	355,593	371,673	385,895	378,082	86,908
- percentages	3.8	4.5	3.8	-2.0	-3.8
Non-profit institutions					
- in CZK millions	8,793	9,506	9,807	10,948	2,812
- percentages	-12.3	8.1	3.2	11.6	6.1
GROSS CAPITAL FORMATION					
- in CZK millions	534,349	552,819	559,901	603,382	146,735
- percentages	6.3	3.5	1.3	7.8	2.6
of which:					
Fixed capital					
- in CZK millions	507,629	524,964	549,815	591,362	141,946
- percentages	5.4	3.4	4.7	7.6	5.5
Changes in inventories					
- in CZK millions	26,627	27,731	9,931	11,861	4,739
Acquisitions less disposals of valuables					
- in CZK millions	93	124	155	159	50
- percentages	-43.8	33.0	25.7	2.6	47.5
FOREIGN TRADE					
of which:					
Exports of goods					
- in CZK millions	1,109,034	1,175,324	1,294,538	1,598,967	417,976
- percentages	14.4	6.0	10.1	23.5	19.5
Exports of services					
- in CZK millions	192,798	162,181	151,004	168,545	38,208
- percentages	-1.2	-15.9	-6.9	11.6	6.7
Imports of goods					
- in CZK millions	1,244,593	1,302,315	1,418,198	1,682,912	413,972
- percentages	14.7	4.6	8.9	19.4	13.5
Imports of services					
- in CZK millions	201,328	214,620	217,569	243,488	54,446
- percentages	3.3	6.6	1.4	11.9	1.7
FINAL DOMESTIC DEMAND					
- in CZK millions	1,723,211	1,780,882	1,860,729	1,912,819	452,657
- percentages	3.7	3.3	4.5	2.8	1.5
AGGREGATE DOMESTIC DEMAND					
- in CZK millions	1,749,931	1,808,737	1,870,815	1,924,839	457,446
- percentages	4.0	3.4	3.4	2.9	0.6
GROSS DOMESTIC PRODUCT AT CURRENT PRICES					
- in CZK millions	2,315,255	2,414,669	2,555,783	2,750,256	682,127
- percentages	7.7	4.3	5.8	7.6	5.8

Source: CZSO

Table 20

LABOUR MARKET

annual percentage changes

A. NATIONAL ACCOUNTS FOR THE HOUSEHOLD SECTOR	2001 Q1 - 4	2002 Q1 - 4	2003 Q1 - 4	2004 Q1 - 4	2005 Q1
Current income	5.7	6.4	5.9	4.7	4.0
of which:					
- gross operating surplus and mixed income	8.3	2.4	7.7	4.9	0.1
- compensation of employees	6.8	8.5	5.5	5.4	4.9
- property income	0.8	-0.9	5.3	8.0	1.0
- social benefits other than social transfers in kind	4.6	8.0	3.6	3.8	6.6
- other current transfers	-9.0	4.1	10.9	-4.5	4.7
Current expenditure	6.6	8.4	9.5	5.9	3.9
of which:					
- property income	1.7	15.1	21.3	11.7	16.7
- current taxes on income, wealth, etc.	5.9	8.2	12.1	5.1	1.3
- social contributions	6.8	8.9	7.2	7.7	6.0
- other current transfers	8.5	4.7	12.5	-2.8	-5.7
Gross disposable income	5.3	5.6	4.3	4.2	4.0
Change in net equity of households in pension funds reserves	23.9	22.6	15.4	16.2	25.5
Individual consumption expenditure	6.4	3.5	6.5	4.8	2.5
Gross saving	-4.7	31.8	-15.5	-1.4	23.7
Gross savings rate	7.93	9.90	8.03	7.60	9.60
(gross saving/gross disposable income - ratio in per cent)					

annual percentage changes

B. AVERAGE WAGES	2001 Q1 - 4	2002 Q1 - 4	2003 Q1 - 4	2004 Q1 - 4	2005 Q1
Whole-economy nominal wage	8.1	7.0	6.4	6.2	5.7
Business sector	7.7	6.3	5.5	6.3	5.0
Non-business sector	9.6	9.8	9.8	5.7	8.9
Whole-economy real wage	3.2	5.1	6.3	3.3	4.0
Business sector	2.9	4.4	5.4	3.4	3.3
Non-business sector	4.7	7.9	9.7	2.8	7.2

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

end of period

C. UNEMPLOYMENT	2001 12	2002 12	2003 12	2004 12	2005 6
Registered job applicants (thousands)	461.9	514.4	542.4	541.7	489.7
Unemployment rate (percentages)	8.9	9.8	10.3	10.3	9.3

Source: CZSO

Table 21

PRODUCER PRICES

percentage changes

	2001	2002	2003	2004	2005 6
Industrial producer prices					
a) previous month = 100	0.1	-0.1	0.1	0.6	-0.2
b) same period of last year = 100	2.9	-0.5	-0.3	5.7	2.7
c) average for 2000 = 100	2.8	2.3	1.9	7.7	10.5
d) December 1999 = 100	6.3	5.8	5.4	11.4	14.3
Construction work prices					
a) previous month = 100	0.3	0.2	0.2	0.4	0.2
b) same period of last year = 100	4.1	2.7	2.2	3.7	2.4
c) average for 2000 = 100	4.1	6.9	9.2	13.3	16.5
d) December 1999 = 100	6.5	9.3	11.7	15.8	19.2
Agricultural producer prices					
b) same period of last year = 100	8.4	-9.5	-2.9	8.1	-9.2
of which:					
crop products					
b) same period of last year = 100	9.3	-4.6	-1.0	11.6	-26.4
livestock products					
b) same period of last year = 100	8.0	-12.1	-4.0	6.1	2.4
Market services prices					
(excluding interest rates)					
a) previous month = 100	0.1	0.3	0.0	0.2	0.4
b) same period of last year = 100	3.9	3.2	1.6	2.3	2.5
c) average for 2000 = 100	4.0	7.3	9.0	11.5	14.6
d) December 1999 = 100	4.6	8.0	9.7	12.2	15.3

Source: CZSO

Table 22

RATIOS OF KEY INDICATORS TO GDP

percentage ratios

	2000	2001	2002	2003	2004
Public budgets balance	-2.9	-2.1	-0.5	-5.1	-3.3
Public debt	15.5	17.5	18.4	21.6	24.0
Debt in convertible currencies	37.6	35.0	33.7	35.0	36.8
Trade balance 1)	-5.6	-5.0	-3.0	-2.7	-0.8
Current account balance	-4.9	-5.4	-5.6	-6.3	-5.2
M2	65.7	68.9	68.4	69.1	67.1

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

Issued by:
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Produced by: Studio Press
Design: Jerome s.r.o.