INFLATION REPORT / OCTOBER

2005

CNB CZECH NATIONAL BANK

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ABBREVIATIONS USED

BCPP	Prague Stock Exchange
CHF	Swiss franc
CNB	Czech National Bank
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
GBP	UK pound
GDP	gross domestic product
GFS	Government Finance Statistics
HICP	Harmonised Index of Consumer Prices
IMF	International Monetary Fund
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
M1, M2	monetary aggregates (see section III.1.1.)
MF	Ministry of Finance
MLSA	Ministry of Labour and Social Affairs
NBS	National Bank of Slovakia
NCG	net credit to government
NDAs	net domestic assets
NEAs	net external assets
NPISHs	non-profit institutions serving households
O/N	overnight
PPI	producer price index
PRIBID	Prague Interbank Bid Rate
PRIBOR	Prague Interbank Offered Rate
(1W, 1M, 1Y)	(one-week, one-month, one-year)
repo rate	repurchase agreement rate
SFAOs	state financial assets operations
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 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 reliable as possible. The Czech National Bank is convinced that reliable monetary policy effectively influences inflation expectations and minimises the costs of maintaining price stability. Maintaining price stability is the Czech National Bank's primary objective.

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 three 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 3 November 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/.

Chart I.1

Inflation returned to the target band at the end of 2005 Q3

(annual change in CPI; percentages)

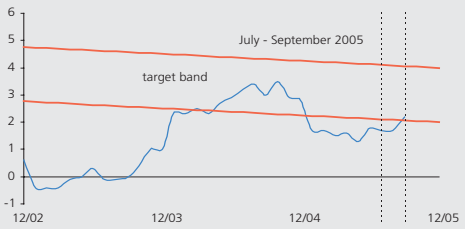


Table I.1

Inflation rose at the end of 2005 Q3

(annual percentage changes unless otherwise indicated)

	06/05	07/05	08/05	09/05
Consumer price inflation	1.8	1.7	1.7	2.2
Industrial producer price inflation	2.7	2.0	1.1	1.0
Money supply growth (M2)	5.2	4.8	4.6	-
3M PRIBOR[a], (in per cent)	1.8	1.8	1.8	1.8
Nominal CZK/EUR exchange rate[a], (level)	30.03	30.19	29.59	29.31
State budget balance since January incl. SFAOs[b] [d], (CZK bn)	3.8	10.3	10.0	25.8
GDP growth at constant prices [c]	5.1			-
Unemployment rate (original metodology)[b], (in per cent)	8.6	8.8	8.9	8.8

a) average for the month
b) end-of-month position
c) figure for the quarter ending with the given month
d) SFAOs stands for "state financial assets operations"

Consumer price inflation rose at the end of 2005 Q3, returning to the target band for the first time in eight months (see Chart I.1). Czech economic growth picked up further and achieved an eight-year record high. This fostered continuing growth in employment and a slight decline in the unemployment rate. Market interest rates rose modestly in 2005 Q3 and the exchange rate of the koruna appreciated in the final two months of Q3.

Annual consumer price inflation rose by half a percentage point in September after a slight slowdown in July and stagnation in August. Despite this increase, however, it remained low. It was in the target band, but close to the lower boundary of the band. The September upswing in annual consumer price inflation was due mainly to rising fuel prices. It was also fostered by growth in regulated prices reflecting the July rise in prices of natural gas for households. A year-on-year decline in food prices acted in the opposite direction.

The gradual upward trend in Czech economic growth, which started in 2003 Q1, continued into 2005 Q2. According to a preliminary CZSO estimate, GDP growth amounted to 5.1%, which is the highest figure since 1996 Q2 (5.7%). The economic growth was driven primarily by net exports. The lead of annual growth in goods and services exports over imports remained substantial. This was due largely to flat domestic demand and a shift of production from Western Europe to the Czech Republic. To a lesser extent, the growth of the Czech economy was fostered by final consumption. The contribution of gross capital formation was negative, owing to a sizeable year-on-year fall in inventories and slackening growth in fixed investment demand.

The growth of the Czech economy and continuing inflow of foreign direct investment fostered an upswing in employment growth, a rise in vacancies and a slight fall in unemployment. However, corporations' growing demand for labour had yet to pass into nominal wages in the business sector. Their year-on-year growth picked up slightly in Q2, but was much lower than a year earlier. However, real wage growth accelerated modestly as a result of the lower average annual inflation. Nominal and real wages in the non-business sector rose at the same rate as in the business sector.

The money market in 2005 Q3 saw a modest rise in interest rates at longer maturities, reflecting an expected gradual increase in monetary policy interest rates next year. On the foreign exchange market, the koruna depreciated slightly against the dollar and to a lesser extent also against the euro in July, but appreciated against both currencies, and in particular against the dollar, in the remaining months of Q3. The koruna's exchange rate continued to be affected primarily by investors' sentiment about the Central European region and the euro-dollar exchange rate.

The monetary policy decision-making of the CNB Bank Board in 2005 Q3 was based on the inflation forecast discussed by the Board at the monetary meeting on 28 July 2005, substantial parts of which were published in the July Inflation Report. Given the monetary policy transmission lag, the Board focused on hitting the inflation target in July–December 2006. According to the forecast, inflation should be close to the point inflation target in this period. Consistent with the baseline scenario of the forecast was interest rate stability over the next several quarters and a moderate rise in rates thereafter.

The Bank Board made no changes to monetary policy interest rates in 2005 Q3. Its decision-making was consistent with the forecast and the related risks, which the Bank Board assessed as moderate and generally balanced. The main upside risks to inflation identified by the Bank Board were the possibility of higher-than-forecasted oil and gas prices, the stronger-than-expected exchange rate of the

dollar and the faster-than-expected recovery in Germany. The main downside risks, according to the Bank Board, were the stronger exchange rate of the koruna and the smaller fiscal impulse which would dampen the impacts of cost shocks on prices, the weaker pass-through of regulated prices into inflation, and the lower-than-expected inflation in Q3 by comparison with the assumptions of the forecast.

Section IV of this Inflation Report describes the CNB's new forecast. The October forecast partially changes the view of the economy going forward. The inflationary effect of the external cost factors, despite their only partial pass-through into other price categories, will lead to a comparatively rapid rise in inflation above the CNB's point inflation target. This will happen despite a persisting negative output gap, which, after closing slightly in 2005 Q3, will widen somewhat in 2006 H1. The expected crossing of the potential output level is postponed to 2008. At the monetary policy horizon, the inflation forecast is just above the CNB's point inflation target. Consistent with the forecast is a gradual rise in interest rates.

Along with the baseline scenario of the forecast, two alternative scenarios were drawn up. The first alternative scenario simulates the effect of sustained high oil prices. This simulation results in a rise in inflation accompanied by higher interest rates amid slower growth in real economic activity. The second alternative scenario assumes a more restrictive fiscal policy this year than in the baseline scenario. According to the simulation, this would lead to a wider output gap, lower inflation and slightly lower interest rates.

Chart I.2
The inflation forecast is just above the point inflation target at the monetary policy horizon
(annual change in CPI; percentages)

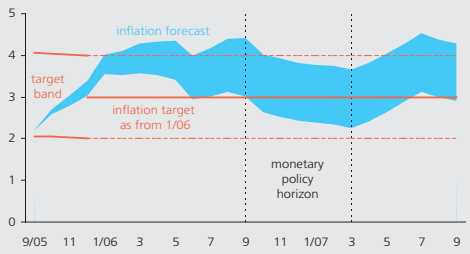


Chart II.1
Annual inflation rose in 2005 Q3
(percentages)

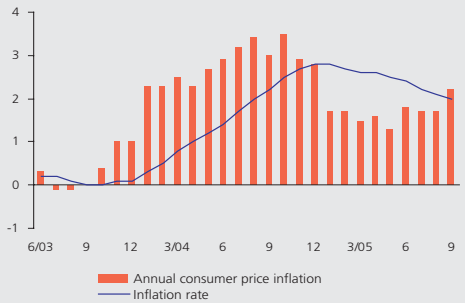


Table II.1
Fuel prices and prices of predominantly regulated items recorded the fastest growth in 2005 Q3
(annual percentage changes)

	4/05	5/05	6/05	7/05	8/05	9/05
Consumer prices	1.6	1.3	1.8	1.7	1.7	2.2
Food and non-alcoholic beverages	-0.8	0.2	0.4	-0.7	-0.8	-0.3
Alcoholic beverages and tobacco	2.7	1.0	0.6	0.2	0.0	0.0
Clothing and footwear	-4.5	-4.7	-4.9	-5.1	-5.5	-5.7
Housing, water, electricity, gas and other fuels	3.6	4.0	4.0	4.1	4.1	4.1
Furnishings, household equipment and routine maintenance of the house	-2.4	-2.0	-2.1	-2.0	-1.9	-2.0
Health	8.0	7.3	7.8	7.7	7.6	7.6
Transport	0.0	-1.2	0.2	2.1	2.2	6.8
Communication	-2.4	-1.3	14.2	14.6	16.1	15.6
Recreation and culture	1.8	1.8	0.9	0.8	0.9	1.1
Education	2.9	2.6	2.5	2.5	2.5	1.4
Hotels and restaurants	7.9	3.7	3.4	3.0	2.9	3.0
Miscellaneous goods and services	1.9	0.8	0.3	0.2	0.2	0.4

Chart II.2
Market prices and regulated prices contributed to the rise in annual inflation in 2005 Q3

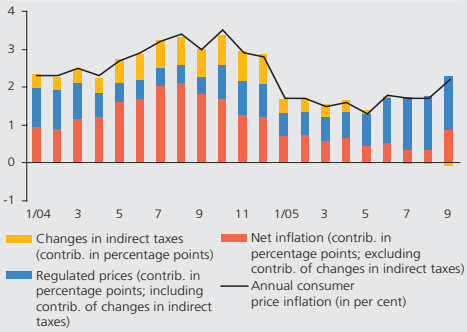
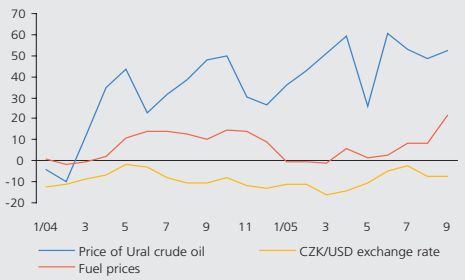


Chart II.3
The impact of the high oil prices on fuel prices was dampened by the koruna-dollar exchange rate and other factors
(annual percentage changes)



II.1 PAST INFLATION DEVELOPMENTS

Inflation increased during 2005 Q3. In July and August it dipped just below the annual outturn recorded at the end of Q2 (to 1.7%), but in September extraordinary factors caused it to rise to 2.2%. Compared to June, consumer price inflation thus accelerated by 0.4 percentage point in September. The inflation rate[1] fell further during Q3 to stand at 2% in September.

The pick-up in annual consumer price inflation during 2005 Q3 was not across the board in nature, manifesting itself in only some components of inflation. Inflation was most affected by a surge in fuel prices connected with the rise in oil prices on world markets. Annual growth in regulated prices also gathered pace, mainly as a result of a July increase in natural gas prices for households. The picture of price movements in the other categories of the consumer basket did not change markedly in Q3. Prices of tradable commodities except fuels continued to decline year on year, and prices of nontradable commodities (predominantly services) continued to show year-on-year growth.

The buoyant growth in prices of energy-producing commodities of foreign and domestic origin[2] continued into 2005 Q3. This growth continued to be partly corrected by year-on-year appreciation of the koruna's exchange rate, albeit to a lesser extent than in the previous period in the case of the koruna-dollar rate. This notwithstanding, import prices of energy-producing materials rose apace, fostering higher growth in prices of products made from oil at the first stages of the "product vertical". In industries producing products with higher value added, the impact of the fast growing energy inputs on production prices is not so noticeable so far. In most branches of industry, producer prices showed only modest growth or a year-on-year decline. Consumer prices – except for fuel and natural gas prices – have also yet to be significantly affected by the rapid growth in energy prices.

Although economic growth remained buoyant in 2005 Q2, by the CNB's estimation the economy had still not reached its potential, non-accelerating inflation level of output. Consumer demand growth did pick up slightly, but was not high. Competition on the retail market remained strong. Inflation was also counteracted by foreign competition, which acted via mostly falling prices of imports. For the above-mentioned reasons, the surging prices of energy-producing resources passed through significantly to consumer prices only in the categories of transport (fuels) and housing (natural gas). Their pass-through via producer prices has been imperceptible so far.

The contribution of market prices[3] to the pick-up in consumer price inflation in 2005 Q3 was larger than that of regulated prices (see Chart II.2). The main reason was the aforementioned year-on-year growth in fuel prices, which fostered a rise in the growth of non-food unregulated commodity prices (of 0.9 percentage point compared to June, to 1.8% in September). However, the overall increase in market prices[4] was more moderate (1.1% year on year), since food prices declined in September (by 0.2%) following a slight rise in June.

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

[2] Prices of coal and electricity increased markedly.

[3] Measured by net inflation. Net inflation = consumer price inflation net of regulated prices and adjusted for other administrative measures.

[4] Market prices (net inflation) = food prices + tradable non-food commodity prices + nontradable commodity prices + fuel prices.

Fuel price growth surged in Q3, from 2.7% in June to 21.6% in September. Underlying this large annual increase was the exceptionally high growth in oil prices on world markets, whose impacts on import prices were only partially attenuated by year-on-year appreciation of the koruna-dollar exchange rate. Chart II.3 shows that the fuel price growth during Q3 was "jumpy" in nature, seemingly reflecting retailers' uncertainty over whether this is a short-lived or longer-term price swing. The other factors correcting the impacts of the fast-rising prices of oil imports on consumer prices are described in more detail in the box *The effect of world energy prices on consumer prices*.

In the category of non-food commodities with market prices, prices of nontradable commodities, which consist predominantly of services, also kept rising. Their price growth, affected mainly by factors of domestic origin, slowed further in Q3, amounting to 2.6% in September in year-on-year comparison. Prices in the categories of housing, hotels and restaurants, recreation and culture contributed most to the achieved growth. The overall slowdown in the price growth of non-food commodities with market prices (except fuels) corresponded to the low level of domestic demand and slackening growth in wage costs.

The year-on-year decline in prices of non-food tradable commodities except fuels, which are affected predominantly by the external competitive environment, continued into Q3. This decline moderated compared to June, amounting to 2.4% in September. The main factor underlying the long-term decline in prices of these commodities was the strong year-on-year appreciation of the koruna's exchange rate combined with the only modest growth, or decline, in prices of many consumer products on foreign markets and the tough competition on the domestic market. A long-running decline in prices has been recorded in the categories of clothing and footwear and household equipment and furnishing in particular.

Food prices, which usually exhibit greater volatility, did not contribute to the upswing in consumer price inflation in 2005 Q3. Their modest year-on-year decline throughout 2005 Q3 (by 0.2% in September)[5] was largely associated with falling agricultural producer prices and food import prices. The low prices of agricultural products fed through into food industry prices and subsequently into food prices on the retail market (see Chart II.5). The effect of the low agricultural producer prices on consumer prices was particularly visible in the categories of bakery products, and potatoes, where consumer prices showed a marked year-on-year decline.[6] Price growth also fell in the high-weight item of meat prices. The increase in excise duties on cigarettes and tobacco products as from 1 July 2005 has not yet passed through into food prices, as stocks are currently being sold off at their original price.

The rise in annual regulated price inflation in 2005 Q3 (by 1 percentage point relative to June, to 6.8% in September) was primarily due to lagged pass-through of the rapidly rising world prices of natural gas into gas supply prices for households. The increase in transport prices was less significant, and other regulated items saw only minor movements with minimal impacts on inflation.

Turning to international comparisons, annual consumer price inflation in the Czech Republic, as measured by the harmonised index of consumer prices (HICP), has been below the inflation level in the EU since the beginning of 2005. According to the figures for August, HICP inflation in the Czech Republic was 1.4%, whereas the HICP published for the EU was 0.8 percentage point higher. However, the latest HICP published for the Czech Republic signalled a greater increase in annual inflation in September, to 2%, for the reasons mentioned earlier in this section (the September EU inflation figures are not yet available).

[5] Consolidated category of food and non-alcoholic beverage prices and alcoholic beverage and tobacco prices.
[6] Bakery product prices fell by 3.4% and potato prices by 7.8% year on year in September.

Chart II.4
Prices of tradable commodities continued falling amid year-on-year appreciation of the koruna and low external inflation
(annual percentage changes, including indirect tax changes)

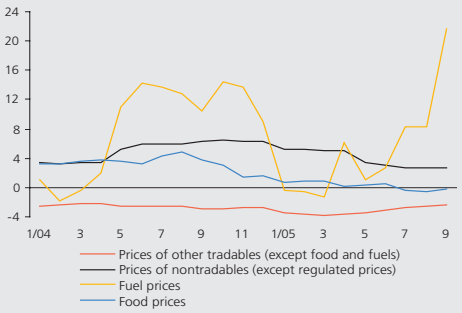


Chart II.5
The persisting sharp fall in agricultural producer prices fostered a modest decrease in food prices
(annual percentage changes)

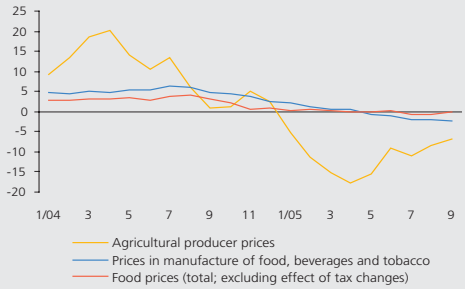


Chart II.6
The faster growth in regulated prices was due primarily to natural gas prices
(annual percentage changes)

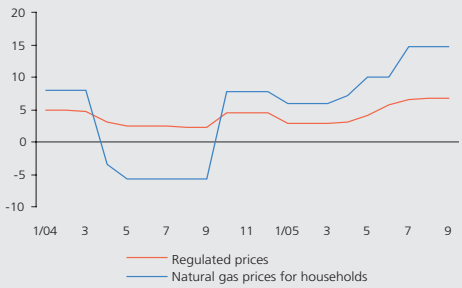


Chart II.7
Inflation in the Czech Republic remained lower than in the EU
(annual percentage changes)

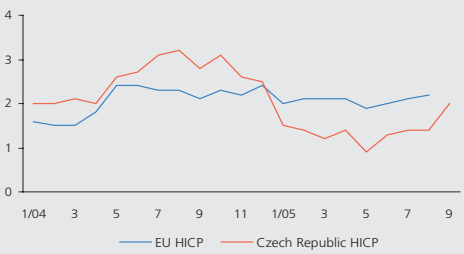


Chart 1 (Box)
Prices of all types of energy have been rising
(annual percentage changes)

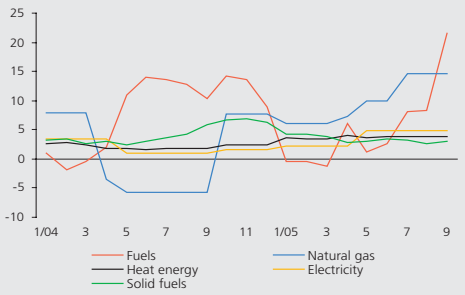


Chart 2 (Box)
Most of the price of fuels consists of taxes
(structure of petrol price at CZK 30/litre; shares in total price)

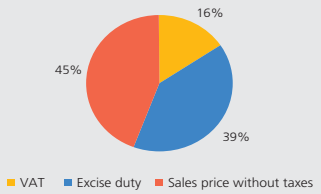


Table 1 (Box)
The rise in energy prices is currently accounting for much of the growth in consumer prices
(annual percentage changes; contributions in percentage points)

	y-o-y growth in September 2005	constant percentage weight in consumer basket	contribution to overall CPI growth
Fuel prices	21.6	3.05	0.62
Natural gas	14.7	1.96	0.38
Heat energy	3.9	3.34	0.14
Electricity	4.9	3.32	0.20
Solid fuels	3.1	0.34	0.01
Total		12.00	1.35

BOX 1
The effect of world energy prices on consumer prices

Inflation has been greatly affected recently by world energy prices. A rise in energy prices impinges directly on consumer basket items such as expenditure on fuels, gas, heat, electricity and solid fuels. Rising prices of energy – given its indispensability – indirectly affect businesses' costs, which implies further inflationary effects on consumer prices (see the box in the April 2005 Inflation Report). By contrast, the indirect effect on households is anti-inflationary. Since energy is a necessary consumption item, rising energy expenditure leads to a decline in households' purchasing power and overall demand. Energy price growth thus generates a combination of inflationary and anti-inflationary pressures, accompanied by a decline in economic activity. In this situation, monetary policy endeavours to eliminate the direct and indirect price effects of the rising energy prices, but at same time takes into consideration the possible impacts of a too restrictive policy on economic activity. This box describes in more detail the direct price effects of energy price growth.

The current rise in energy prices was triggered by growing oil prices. The oil price started increasing rapidly in 2004, and the average price of Ural crude oil peaked at USD 59 a barrel in August. The direct inflationary impact of the oil price is greatly dampened by the fact that the purchase costs of the raw material form only around one-third of the final price of fuel, as most of the price consists of taxes (see Chart 2). Over recent years, moreover, margins in fuel manufacture, distribution and sale have fallen considerably in the Czech Republic. Year-on-year growth in fuel prices was 21.6% in September and had an impact of 0.6 percentage point on inflation (see Table 1).

The growth in world oil prices was followed by similarly high growth in world prices of natural gas, which directly affect regulated prices (natural gas prices for households and subsequently heat prices). The price of natural gas for households is set by the Energy Regulatory Office based on the costs of the industry as a whole. The heat price is regulated on a cost-plus basis, reflecting changes in eligible costs. These regulated prices are thus derived largely from world raw material prices and are close to their market values. In September, the year-on-year growth in the natural gas price for households was 14.7%, with an impact of around 0.4 percentage point on inflation. On 1 October 2005, prices were increased by a further 17.4%.

Prices of electricity and solid fuels are affected largely by domestic cost factors, hence world price developments have no direct cost effect on them. However, the possibility of exporting production at higher prices can push up their domestic prices. The price of electricity for households is set by the Energy Regulatory Office. In September, the year-on-year growth in the price of electricity for households was 4.9%, with an impact of around 0.2 percentage point on inflation. Export prices of solid fuels, which can partly substitute for natural gas for heating, have also seen growth lately. However, this rise has not yet generated any pick-up in domestic consumer prices of solid fuels (see Table 1).

II.2 FULFILMENT OF THE INFLATION TARGET

Actual inflation was just below the CNB's target band on average in 2005 Q3 (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 Q3, one needs to analyse retrospectively the forecasts, and the Bank Board's decisions based thereon, dating from around January to September 2004. For comprehensibility, the analysis of the accuracy of the forecasts is limited here to a comparison of the forecast drawn up in April 2004, i.e. approximately in the middle of the aforementioned period, with inflation in 2005 Q3 (see Table II.2).

The April 2004 forecast had predicted easy monetary policy, primarily via an easy exchange rate component of the monetary conditions. This prediction, together with an expected recovery in external economic activity, was to 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 and regulated prices were also to join the inflationary effect of the closing output gap. The April forecast thus predicted for 2004 a rapid rise in inflation towards the upper boundary of the target band, followed by a gradual decline towards the centre of the band. In reality, inflation was lower over the entire forecast horizon, and 1.1 percentage point lower in 2005 Q3 (see Chart II.8). A closer look at the inflation structure reveals that adjusted inflation excluding fuels and growth in food prices in 2005 Q3 were considerably lower than the forecast. By contrast, the growth in regulated prices and fuel prices was higher than forecasted.

The lower consumer price inflation in 2005 Q3 than forecasted in April 2004 can be put down partially to factors lying partly or completely outside the purview of the CNB's monetary policy. The factors acting towards lower inflation included lower agricultural producer prices, lower external demand and a smaller fiscal impulse relative to the forecast. In addition, the exchange rate had an anti-inflationary effect, being stronger than forecasted, even taking into account the new information. The anti-inflationary effect of these factors was only partly offset by the higher growth in regulated prices, higher oil prices and consequently also higher external inflation (see Table II.3).

Consistent with the April forecast was a gradual rise in interest rates at the two-year horizon. The actual interest rate path was beneath the forecast. Although interest rates were increased twice in summer 2004, they were cut by 0.75 percentage point overall during 2005 H1. In the key period as regards the most recent consumer price developments, i.e. in the first three quarters of 2004, nominal interest rates were slightly lower than forecasted. However, interest rates in real terms were broadly in line with the forecast thanks to lower-than-forecasted inflation. In both nominal and real terms, the exchange rate was tighter than originally predicted in the forecast. Overall, then, the monetary policy effect was slightly tighter than forecasted in April.

An integral part of the assessment of the fulfilment of forecasts is a discussion of any changes in the CNB's view of the functioning of the economy since the forecast was prepared. As the CNB has not changed this view since April 2004, no significant change was made to the forecasting system in this period.

When assessing the fulfilment of the April forecast, one should also take into account revisions to the available economic indicators – particularly GDP – released since the forecast was drawn up. Major revisions to the national accounts were made in

Table II.2
Headline inflation in 2005 Q3 was lower than forecasted in April 2004
(annual percentage changes; contributions in percentage points)

	April 2004 forecast	2005 Q3 outturn	Contribution to total difference in perc. points [a]
Annual consumer price inflation	3.0	1.9	-1.1
Breakdown into contributions:			
regulated prices	2.4	6.7	0.9
indirect taxes	0.0	0.0	0.0
food prices, excluding effects of indirect taxes	3.2	-0.5	-1.0
fuel prices, excluding effects of indirect taxes	-1.0	12.7	0.2
adjusted inflation excluding fuels, excluding effects of indirect taxes	3.3	0.6	-1.3

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

Chart II.8
Actual inflation was lower over the entire forecast horizon
(annual percentage changes)

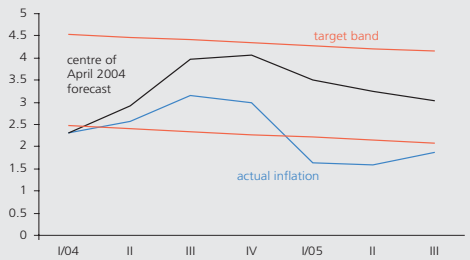


Table II.3
Of the exogenous factors, external demand and the price of oil deviated the most from the forecasts

		II/2004	III/2004	IV/2004	I/2005	II/2005	III/2005
GDP in Germany [a]	prediction	1.6	1.8	2.0	1.5	1.7	1.8
(annual perc. changes)	outturn	2.1	1.2	1.3	0.4	0.8	-
CPI in Germany	prediction	1.2	1.3	1.3	1.1	1.2	1.2
(annual perc. changes)	outturn	1.8	1.9	1.9	1.7	1.7	2.1
1Y EURIBOR	prediction	2.0	2.0	2.1	2.3	2.5	2.6
(percentages)	outturn	2.3	2.3	2.3	2.3	2.2	2.2
USD/EUR exchange rate	prediction	1.23	1.25	1.25	1.25	1.24	1.22
(levels)	outturn	1.20	1.22	1.30	1.31	1.26	1.22
Oil prices [b]	prediction	28.4	27.1	26.5	26.1	26.1	26.1
(USD/barrel)	outturn	32.2	38.0	37.3	42.8	47.6	57.3

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

December 2004 and in June and September this year. Overall, these revisions did not significantly 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 April forecast was drawn up can be briefly interpreted as follows.

A combination of slightly tighter monetary policy conditions in the key period (January 2004 – September 2004), a smaller fiscal impulse and lower external demand led to slower-than-forecasted closure of the output gap. The wider output gap manifested itself in lower growth in adjusted inflation excluding fuels. This, coupled with lower food prices as a result of the above-average harvest in 2004 and with an unexpectedly rapid appreciation of the koruna, has led to lower-than-forecasted overall inflation in the year to date.

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 the first three quarters of 2004 (see the relevant minutes), the overall perception of the risks was broadly balanced (the January forecast inflationary, the April forecast anti-inflationary and the July forecast roughly neutral). It is possible to say, with the benefit of hindsight, that the anti-inflationary risks materialised to a greater extent. Monetary policy could therefore have been easier and could thus have reduced the extent of the undershooting of the inflation target in 2005 Q3.

Table II.4

A tighter exchange rate, lower external demand and tighter fiscal policy led to slower closure of the output gap

		II/2004	III/2004	IV/2004	I/2005	II/2005	III/2005
3M PRIBOR	prediction	2.5	2.9	3.3	3.5	3.7	3.9
(percentages)	outturn	2.2	2.6	2.6	2.3	1.9	1.8
CZK/EUR exchange rate	prediction	32.6	32.4	32.2	32.1	31.9	31.6
(levels)	outturn	32.0	31.6	31.1	30.0	30.1	29.7
GDP	prediction	3.8	4.1	4.8	4.1	4.0	3.8
(real, annual perc. changes)	outturn	4.5	4.6	4.6	4.7	5.1	-
Output gap	prediction	-0.8	-0.2	0.1	0.4	0.7	0.9
(percentages of GDP)	outturnt [a]	-1.4	-1.1	-0.9	-0.6	-0.4	-0.3

a) estimate based on the CNB's October 2005 forecast

III.1 THE EXTERNAL ENVIRONMENT

The growth of the US economy continued to significantly outpace the growth of the euro area in 2005 Q2. The dollar's exchange rate against the euro initially depreciated for almost two months, falling below USD 1.25/EUR, but rebounded during September to USD 1.21/EUR. At the end of August, the price of WTI crude oil reached record highs of USD 70 per barrel, but after several days it returned to a level USD 5 lower and stayed approximately at this level until the end of September. The average price of WTI crude oil was 19% higher in 2005 Q3 than in the previous quarter and 44% higher than in the same period a year earlier.

Year-on-year economic growth in the USA remained at 3.6% in 2005 Q2. Compared to 2004 as a whole, when a figure of 4.4% had been recorded, this represents a decline in growth rate, but in the light of the euro area's results it is still relatively high. Household consumption increased rather faster than last year, and the external sector saw an improvement, but investment growth slowed slightly.[7] The state budget was favourable, the deficit for the eleven months of the current fiscal year being USD 80 billion lower than a year earlier. In contrast, the unemployment rate rose by 0.2 percentage point to 5.1% in September, following eight months of decline. However, even this level is very favourable compared to the euro area in both historical and relative terms.

As a result of the high oil prices, consumer price inflation rose from 3.2% in July to 3.6% in August and 4.7% in September. Over the same period, industrial producer price inflation increased to 5.1% and 6.9%. On 20 September, the Fed decided to increase its key rate by 0.25 percentage point to 3.75%, the eleventh such rise in a row. The Fed put concerns of higher inflation ahead of efforts to promote growth in the hurricane-hit economy. It accompanied its decision with the by now standard comment on a "measured pace" of rate growth.

In the euro area, annual GDP growth continued to decline in 2005 Q2, falling to 1.1% from 1.3% in the previous quarter. The slowdown was due to lower growth in household consumption. Growth in goods and services exports also fell, but this was roughly offset by lower imports. The current account surplus of previous periods changed into a deficit of over EUR 15 billion. Despite the weak economic growth, the unemployment rate has been moving around 8.6% since May 2005 and was down by 0.3 percentage point compared to August 2004.

Consumer price inflation, which had been moving around the 2% level or slightly above it since the start of the year, increased to 2.6% in September owing to the high oil prices. Industrial producer prices also recorded a big increase for the same reason, moving around 4% over the last three months. The ECB's interest rates remained unchanged at 2%, but the bank indicated that it was focusing on the unfavourable price developments and was assigning less weight to the low economic growth in the euro area in its considerations about the monetary policy settings.

Economic growth in Germany was very slow and remained below the euro area level in 2005 Q2. As in the euro area as a whole, it decreased by another 0.2 percentage point in this quarter. An improvement in private investment and government consumption – amid flat household consumption – only partially offset a decline in the net export surplus caused by lower export growth. Low retail sales growth in August also testified to an unfavourable private consumption situation.

Chart III.1
Oil prices reached record highs at the turn of August and September 2005, the price of WTI touching USD 70 a barrel
(USD/barrel)

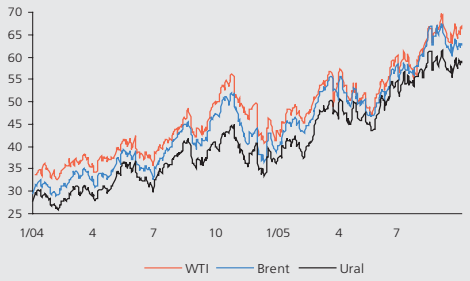


Chart III.2
From July the dollar weakened to USD 1.25/EUR, but in September it rebounded to USD 1.21/EUR

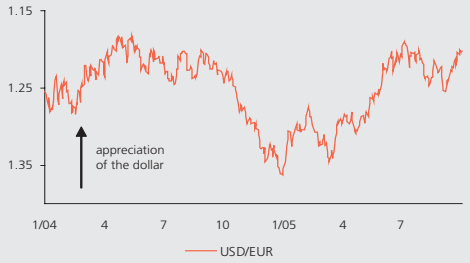
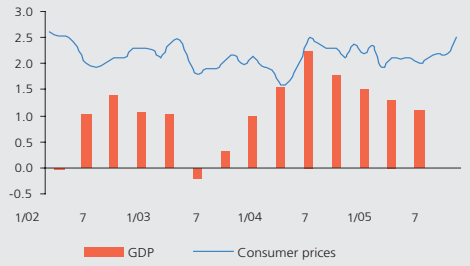


Chart III.3
Economic growth in the euro area fell again in 2005 Q2, while inflation increased
(annual percentage changes)



[7] The overall economic situation in Q3 was significantly affected by hurricanes Katrina and, to a lesser extent, Rita. Besides causing direct losses running to hundreds of billions of dollars, the hurricanes also affected GDP, prices, unemployment and the state budget. The effects have yet to show up in the statistical data and only estimates are available.

The low economic growth was also reflected in a high unemployment rate, which has been roughly 11.7% since the start of 2005. Together with France, Germany has the highest unemployment rate in the euro area and among the EU 15 countries.

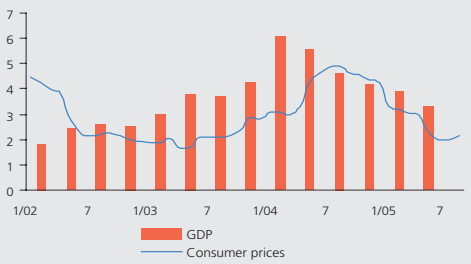
Germany, too, saw a pick-up in consumer price inflation as a result of the higher energy prices. German consumer price inflation in Q3 was 0.5 percentage point higher on average than in Q2, and jumped to 2.5% in September compared to 1.9% in July and August. Similar developments for the same reasons were also recorded for industrial producer prices, whose growth rates were 0.3 percentage point higher in Q3 than in Q2.

The countries of the Central European region achieved generally positive economic results in 2005 Q2 and Q3. Their economic growth further accelerated (except in the case of Slovakia). Unemployment decreased in Q3. The exchange rates of all the regional currencies against the euro again strengthened.

Chart III.4

Although GDP growth is much higher in the "new" EU Member States than in the euro area, it has been slowing for over a year now

(annual percentage changes)



Hungarian GDP was up by 4.1% year on year in 2005 Q2, compared to 2.9% in the previous quarter. This higher growth was mostly attributable to net exports (export growth outpaced import growth by 7 percentage points) and household consumption, which in this period was also reflected in a high increase in retail sales. The unemployment rate was flat at 7.1% for the third consecutive month in August and, despite being the lowest in the Central European region, was more than one percentage point higher than in the same period of 2004. Consumer price inflation in Hungary, the highest in the Central European region, rose slightly to 3.7% in September. Compared to the previous year it was down by almost three percentage points. Despite the energy price growth, industrial producer price inflation slowed to 3.4% in August owing to low wage growth and an appreciation of the exchange rate of the forint against the euro in Q3. The favourable macroeconomic situation allowed the Hungarian central bank to lower its rates three times in Q3, by a total of one percentage point to 6%.

Poland's economic growth was the slowest in the Central European region, despite rising year on year from 2.1% in 2005 Q1 to 2.8% in Q2. Compared to 2004, when the growth rate had exceeded 5%, this is, however, still a very low figure. Rising investment and net exports (thanks particularly to a fall in imports) contributed most to the GDP growth, whereas household consumption saw only very weak growth. The trade balance and the current account both developed favourably. The July current account deficit was more than EUR 300 million, but the moving cumulative value for the last twelve months was positive. The goods and services balance improved and transfers from the EU increased. Unemployment decreased further in August, falling by 1.3 percentage points compared to August 2004. Thanks to weak nominal wage and consumer demand growth and the zloty's appreciation (of 9% in Q3 in nominal terms), Polish consumer price inflation is one of the lowest in the region, and industrial producer prices have even been flat over the last three months. The Polish national bank reacted to the low economic growth and favourable inflation by twice lowering rates by 0.25 percentage point, to 4.5%.

In Slovakia, GDP grew by 5.1% in 2005 Q2, as in Q1. Together with the Czech Republic, Slovakia thus has the strongest economic growth in the region. The buoyant growth was the result of increasing household consumption and, in particular, rapidly rising investment, which recorded double the Q1 growth rate. Net exports deteriorated, having a negative effect on growth. The strong domestic demand growth did not pass through into higher inflation, but did worsen the external imbalance. The cumulative trade and current account deficits more than doubled in the first seven months of this year compared to the previous year. Nevertheless, this does not constitute a disturbance to the fundamental

macroeconomic balance, since these deficits resulted from massive foreign industrial investment and the upgrading of Slovak car manufacturers' production lines. Although the unemployment rate increased by 0.3 percentage point to 11.2% in September, it was still almost 2 percentage points lower than a year earlier. Despite the strong domestic demand growth, consumer price inflation decreased to 2% in July and August, owing to appreciation of the Slovak koruna, low wages and high labour productivity growth. In September, however, it rebounded by 0.2 percentage point due to higher energy prices. Oil prices were also the cause of an August rise in producer prices, whose growth rate doubled compared to the beginning of the year. The NBS has left its key rate unchanged at 3% since the beginning of March.

III.2 THE MONETARY CONDITIONS

According to the CNB's calculations, the settings of the real monetary conditions in 2005 Q3 can generally be characterised as neutral to slightly easy. The interest rate component was easy, whereas the exchange rate component was slightly tight.[8] The evolution of the interest rate and exchange rate components of the monetary conditions in 2005 Q3 is described in more detail below.

III.2.1 Interest rates

The CNB did not change its key rates in 2005 Q3. The 2W repo rate remained at 1.75%, the Lombard rate at 2.75% and the discount rate at 0.75% with effect from 29 April 2005. Nonetheless, interest rates started to increase slightly at all maturities. The main reason was a change in financial market participants' expectations regarding interest rates going forward.

Interest rates reached historical lows around the turn of June and July. The main factors behind this were the relatively strong koruna and the absence of demand-pull inflationary pressures in the Czech economy. However, most financial market participants have gradually come to agree that the period of rate cuts is over and that the next change to the CNB's key rates will be upwards. Money market interest rates rose by about 0.1-0.2 percentage point. More marked growth (of up to 0.4 percentage point) was recorded by IRS rates with maturities ranging from 1Y to 5Y. These rates were affected by financial market developments in the euro area and the USA, where expectations regarding an increase in key interest rates also rose. Conversely, IRS rates with maturities over 5Y were dominated by concerns about the negative impact of oil prices on world economic growth, so these rates rose to a lesser extent. Yields on bonds with maturities over 5Y were also generally flat, owing to the limited supply of these bonds linked with the favourable state budget performance. PRIBOR spot quotations and FRA forward quotations at the end of September 2005 indicated that the majority of the financial market expected the first monetary policy tightening to occur around the start of 2006 Q2.

The slope of the PRIBOR yield curve gradually changed from neutral to slightly positive. The spread between the 1Y PRIBOR and the 2W PRIBOR was 0.12 percentage point in September. By contrast, the slope of the IRS yield curve decreased thanks to growth in rates at its shorter end, but its slope remained positive. The average 5Y-1Y spread was 0.78 percentage point and the 10Y-1Y spread 1.33 percentage points in September.

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

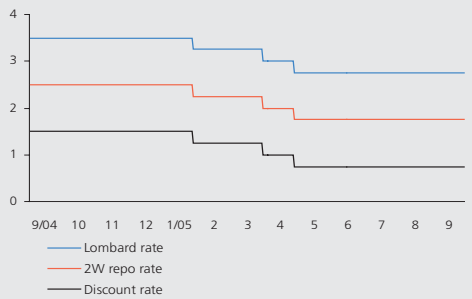
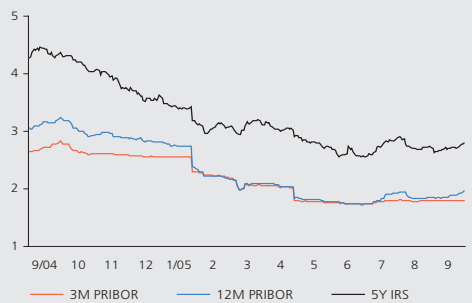


CHART III.6
Market interest rates edged upwards
(percentages)



8 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.

Chart III.7
The interest rate differentials of the koruna vis-à-vis the euro and the dollar fluctuated in negative values
(percentage points)

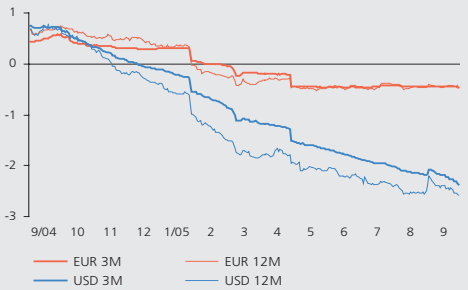


Chart III.8
Ex ante real interest rates were little changed
(percentages)

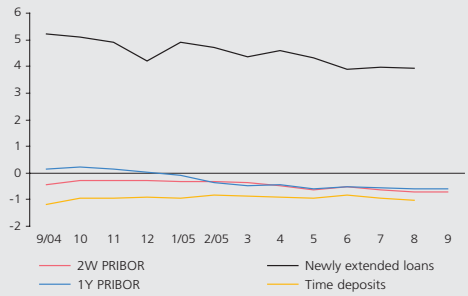
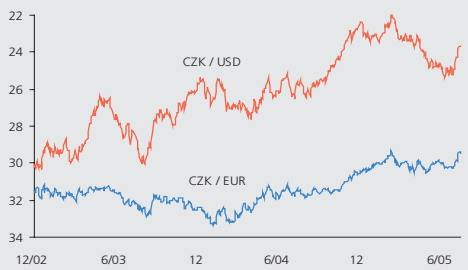


Chart III.9
The koruna depreciated against the dollar in 2005 Q3



The interest rate differential (PRIBID/CZK-LIBOR/EUR, USD) was affected by changes in key rates and movements in interbank market rates. The key rates in the two most important economies developed differently. The Fed raised rates further in two steps (O/N rate: 3.75%), 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 on the primary government bond market, with original maturities of 5Y–15Y and a total volume of CZK 27.8 billion. Only one auction was relatively unsuccessful, the others were subscribed without problems. Fitch Ratings upgraded the Czech Republic's long-term foreign currency rating by one notch to A and its local currency rating to A+ with a stable outlook. The Czech Republic's short-term foreign currency rating improved to F1. The agency at the same time pointed to the need to continue with fiscal reform.

The evolution of interest rates on the financial market is also reflected in client interest rates. Nominal interest rates on new loans amounted to 5.3% in August. Since the start of the year these rates have fallen by about 0.8 percentage point, i.e. to the same extent as the CNB's key rates. Rates on new time deposits were 1.4%. The interest rate margin between the overall loan and deposit rates is not subject to sizeable fluctuations; it stood at 4.5 percentage points in August.

Real interest rates [9] are affected not only by the level of nominal rates, but also by movements in inflation expectations. Expected consumer price indices are traditionally higher than expected industrial producer price indices. This fact is reflected in the levels of the individual real interest rates. Real rates on new loans were 3.9% in August, while real rates on time deposits were -1.0%.

III.2.2 The exchange rate

The average exchange rate of the koruna against the euro was CZK 29.68/EUR in 2005 Q3, which represents a year-on-year appreciation of 6% (and a quarter-on-quarter appreciation of 1.5%). The appreciation trend (visible since 2004 Q2) was thus renewed in August, following a temporary halt in 2005 Q2 and July.

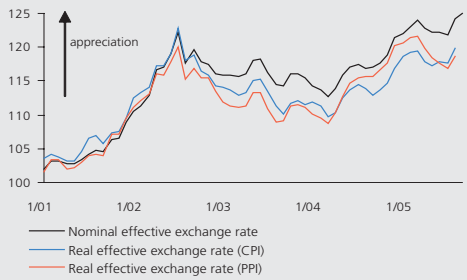
Movements of short-term capital reflecting foreign investors' sentiment about the Central European region remained the main factor affecting the exchange rate. However, investors' interest in the individual countries of the region differed (the koruna's appreciation was weaker than the zloty's, but stronger than the forint's). Unlike in other Central European economies, the Czech koruna's appreciation occurred amid a slightly negative or zero interest rate differential against the euro and a relatively pronounced and, moreover, increasing negative differential against the dollar. The koruna's appreciation despite the negative interest rate differential was possible chiefly thanks to strong export growth, which greatly improved the trade balance and thus the current account as a whole. Thanks to the favourable development of the trade balance, this year is the first in many not to have seen any demand for foreign currency associated with the current account deficit. The current account is recording a deficit this year only because of the inclusion of some items not connected with real demand for foreign currency (reinvested earnings of non-residents, imports associated with the de-blocking of assets, and the value of JAS Gripen fighter aircraft acquired under long-term lease). The exchange rate has also been affected by the upgrading of the Czech Republic's rating by Fitch Ratings.

[9] 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.

The average exchange rate of the koruna against the dollar was CZK 24.3/USD in 2005 Q3, which represents a year-on-year appreciation of 6%, the same as against the euro. In quarter-on-quarter terms, however, the koruna depreciated against the dollar by about 1.5%. The halt in the koruna's long-term appreciation trend against the dollar (which had lasted from October 2000 until March 2005) and its depreciation against the dollar as from 2005 Q2 were caused primarily by the evolution of the dollar exchange rate on world markets. This chiefly reflects gradual changes 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.

The nominal effective exchange rate of the koruna appreciated by 5.5% year on year in 2005 Q3 (compared to a full 6.8% in September 2005), owing mainly to the koruna's year-on-year appreciation against the euro and the dollar. This appreciation was moderated above all by the koruna's exchange rate against the zloty and the Slovak koruna. Compared to the previous quarter, the year-on-year appreciation of the koruna's nominal effective exchange rate was somewhat slower, mainly due to depreciation against the dollar and the zloty. Owing to the evolution of the koruna's nominal exchange rate, the year-on-year appreciation of the real effective exchange rate deflated by both the CPI and the PPI moderated as well. In August 2005, the CPI-deflated real effective exchange rate was up by 5.2% year on year. The annual growth of the PPI-deflated real effective exchange rate was much weaker than that of the nominal rate (2.6% in August), owing to substantially lower industrial producer price inflation in the Czech Republic than in other countries.

Chart III.10
The nominal effective exchange rate continued to show year-on-year growth in 2005 Q3
(year 2000 = 100)



III.3 THE BALANCE OF PAYMENTS

III.3.1 The current account

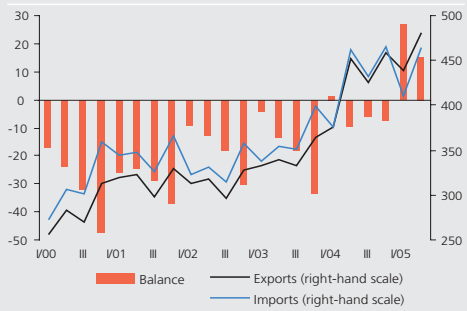
The current account ended 2005 H1 in a deficit of CZK 12.3 billion, or 0.9% of GDP. This was the lowest deficit since 1994. The year-on-year improvement in the current account amounted to CZK 39.3 billion. This chiefly reflected an improvement in the trade balance (of CZK 50.5 billion year on year) and a one-off effect related to damages of CZK 12.6 billion paid to ČSOB by the Slovak Republic. The overall improvement on the current account was, however, moderated by growth in the income deficit, related above all to non-residents' rising FDI earnings and, to a lesser extent, to a growing deficit on compensation of employees. Other changes were insignificant.

The trade surplus amounted to CZK 42.0 billion in 2005 H1, a year-on-year improvement of CZK 50.5 billion as mentioned above. Thanks to developments in Q1, the trade balance in H1 was still favourably affected by prices (the terms of trade improved by 0.2% year on year, but saw a slight deterioration of 0.9% in Q2). Export growth also slowed gradually, reaching 10.7% in H1 but only 5.9% in Q2. The improving trade balance again chiefly reflected changes in the SITC 7 category (machinery and transport equipment), where the surplus increased by CZK 44.2 billion. The more marked improvement in two other SITC categories (chemicals and manufactured goods) is, however, a new phenomenon. Both these categories improved by almost CZK 10 billion year on year. The trade balance improvement is attributable to changes on the supply side, reflected in a rise in the physical volume of exports. This improvement, however, was offset by a deterioration of CZK 15.6 billion in the SITC 3 category (mineral fuels). Around two-thirds of this deterioration was due to a price effect related to year-on-year growth in oil and natural gas prices, while the rest was caused by an increase in the physical volume of imports. The changes in other groups were rather insignificant. From the geographical perspective, the trade balance

Table III.1
The current account deficit narrowed due to an improvement in the trade balance
(CZK billions)

	2002 H1	2003 H1	2004 H1	2005 H1
A. Current account	-47.0	-45.0	-51.6	-12.3
Trade balance	-22.4	-17.8	-8.5	42.0
Services	18.7	7.5	8.1	8.4
Income	-49.1	-40.2	-55.3	-77.8
Transfers	5.7	5.5	4.0	15.1
B. Capital account	0.0	-0.1	0.9	2.8
C. Financial account	235.6	56.8	50.2	90.4
Direct investment	194.8	51.5	56.2	168.4
Portfolio investment	10.7	-39.0	64.1	-20.5
Financial derivatives	-4.1	2.9	3.9	-0.9
Other investment	34.2	41.4	-73.9	-56.6
D. Errors and omissions	-14.3	-2.0	6.2	6.1
Change in reserves (- = increase in reserves)	-174.4	-9.7	-5.7	-86.9

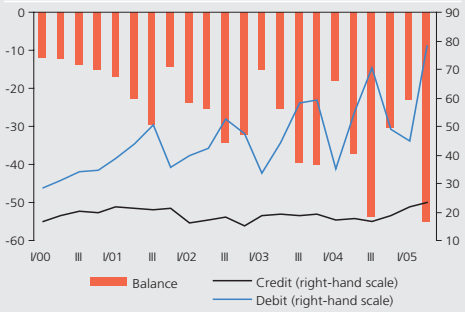
Chart III.11
The trade surplus increased significantly year on year in 2005 Q2
(CZK billions)



improvement was again due primarily to an increase in the trade surplus with the EU (25), which grew by CZK 37.8 billion to CZK 155.7 billion. However, the decrease in the deficits with other major trading partners, i.e. the USA, Japan and China, was something new. Among the Czech Republic's major partners, only the trade balance with Russia deteriorated.

The surplus on services remained virtually unchanged year on year (CZK +0.3 billion) and amounted to CZK 8.4 billion. An annual increase in surplus was apparent especially in transport (of CZK 3.1 billion), particularly air transport. However, this rise was almost eliminated by a deteriorating balance on other services, due to faster growth in payments, particularly for intermediation services, rental and leasing, reinsurance, licence fees, etc.

CHART III.12
The income deficit increased significantly year on year in 2005 Q2
(CZK billions)



The income deficit increased by CZK 22.5 billion year on year, to CZK 77.8 billion. This increase was attributable chiefly to rising earnings of non-residents, which were visible under both foreign direct investment and portfolio investment. Payments of dividends increased but, according to preliminary estimates, reinvested earnings grew as well. The deficit under compensation of employees recorded a further increase, mainly as a result of the rising number of foreigners working in the Czech Republic. The rise in the income deficit was offset primarily by an increase in income on CNB international reserves and commercial banks' interest income on deposits abroad.

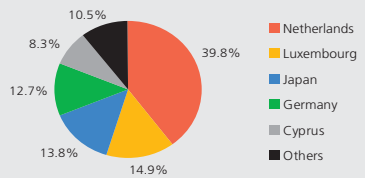
Current transfers ended in a surplus of CZK 15.1 billion, up by CZK 11.1 billion on a year earlier. However, this improvement was due exclusively to damages paid by the Slovak Republic to ČSOB in Q1 for losses dating from the division of Czechoslovakia under an international arbitration decision (CZK 12.6 billion). ČSOB kept these funds in Slovakia. Adjusted for this transaction, the current transfers balance continued to record the moderate year-on-year deterioration observed since 2002. This was primarily due to the unwinding of insurance companies' receipts from foreign reinsurance following the floods in 2002. Current transfers are not yet being significantly affected by EU budget payments and revenues, which were roughly balanced in H1.

III.3.2 The capital account

The capital account ended in a surplus of CZK 2.8 billion (compared to only CZK 0.9 billion in the same period a year earlier). The surplus essentially corresponded to a subsidy from the EU Structural Funds. The annual improvement is largely due to the May EU entry date last year. Other transactions were insignificant.

III.3.3 The financial account

CHART III.13
Firms registered in the Netherlands were the largest foreign investors in 2005 H1



The financial account showed a surplus of CZK 90.4 billion in 2005 H1 (compared to a surplus of CZK 50.2 billion in the same period of 2004). The annual growth in the financial account surplus was due to a rise in the direct investment surplus, which, in turn, was affected by one-off sales of property to non-residents and an annual increase in reinvested earnings of non-residents in the Czech Republic and also a rise in the volume of funds obtained by the government from abroad (drawings on loans and de-blocking of assets) under other investment. The financial account surplus was reduced chiefly by a change in portfolio investment flows (inflow being replaced by outflow), which was associated largely with the effects of monetary policy (particularly the lowering of domestic interest rates) and an increase in commercial banks' short-term foreign assets and a decline in their short-term foreign liabilities.

Direct investment recorded a surplus of CZK 168.4 billion, representing a sizeable annual rise in the net inflow (of CZK 112 billion). The inflow of foreign direct

investment (including reinvested earnings) was CZK 170.3 billion, which represented a year-on-year change of almost the same size as in the case of the FDI balance. Sales of property to non-residents (Telecom, Unipetrol, TV Nova) accounted for most of the FDI; their price roughly corresponded to the annual improvement in the FDI balance. Reinvested earnings of non-residents again slightly increased and are estimated at CZK 40 billion. With the exception of the major sales of property mentioned above, the foreign capital inflow continued falling, amounting to less than CZK 20 billion (including loans). It was channelled primarily into real estate (about 80%), industry (about 15%) and trade (about 5%). The biggest investors (excluding the sales of property) were the Netherlands, Japan, Luxembourg, Germany and Cyprus. Czech direct investment abroad was only CZK 1.9 billion.

The net outflow of portfolio investment was CZK 20.5 billion, contrasting with the net inflow of CZK 64.1 billion recorded in the same period of 2004. In Q2 alone, however, the outflow stopped rising. The year-on-year change in capital flows of almost CZK 85 billion was influenced mainly by residents' growing interest in foreign debt securities and non-residents' declining interest in domestic koruna-denominated debt securities, probably as a result of the change in the interest rate differential. A decline in non-residents' interest in domestic equity securities was also apparent. The outflow of foreign capital was not accompanied by a fall in prices as seen in the past, since residents' interest in holding domestic shares increased.

Financial derivatives transactions generated a CZK 0.9 billion decrease in the financial account surplus.

Other investment recorded a net capital outflow of CZK 56.6 billion. This consisted exclusively of short-term banking transactions, which exceeded CZK 80 billion (with growth in short-term assets accounting for about half and a decline in short-term liabilities for the other half). The growth in assets was associated primarily with the damages paid to ČSOB and retained in Slovakia, and also with exchange rate hedging of the government Eurobond issue on the European market. The outflow of short-term capital via the banking sector was partly offset by an inflow of capital via the government sector amounting to CZK 16.2 billion (chiefly loans from the EIB for the construction of infrastructure and the de-blocking of assets in Russia). Net borrowing by the business sector totalled CZK 9.0 billion, consisting mostly of short-term trade credits.

The international reserves decreased by CZK 12.6 billion to CZK 733.9 billion in 2005 Q3. This was due mostly to valuation changes and, to a lesser extent, to continuing sales of returns on reserve holdings on the foreign exchange market. The international reserves in dollar terms decreased by USD 0.2 billion to USD 29.9 billion in Q3. Since the start of the year they have increased by almost CZK 100 billion (chiefly because of transactions to eliminate the impacts of the sale of the state-owned stake in Telecom on the foreign exchange market).

III.4 MONETARY DEVELOPMENTS

Money growth in Q2 was consistent with GDP growth at current prices. M2 growth remained relatively low. The slightly easy interest rate component of the monetary conditions and the low nominal interest rates encouraged demand by economic agents for liquid money. The favourable financing conditions also fostered further growth in credit. This growth was accompanied by a change in the structure of funds in non-financial corporations. Housing loans and consumer credit continued to grow, leading to a further rise in total household indebtedness.

Chart III.14
Portfolio investment flows were approximately balanced in 2005 Q2
(CZK billions)

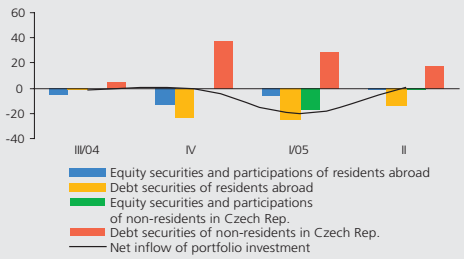


Chart III.15
The international reserves decreased moderately in dollar terms in 2005 Q3
(USD billions)

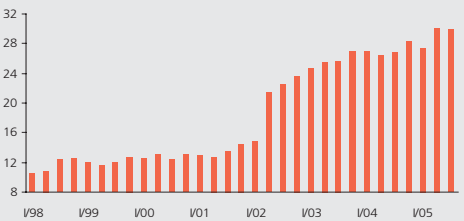


Chart III.16
Monetary aggregate growth remained fairly subdued in Q2 and in August
(annual percentage changes)

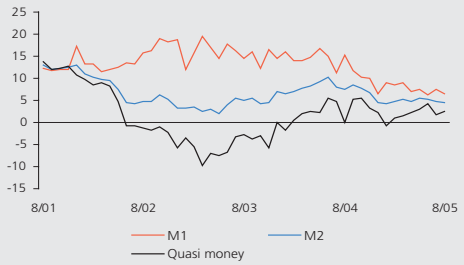


Chart III.17
The lower M2 growth was consistent with GDP growth at current prices
(annual percentage changes)

Chart III.18
Deposits of households and non-financial corporations recorded slower growth
(annual percentage changes)

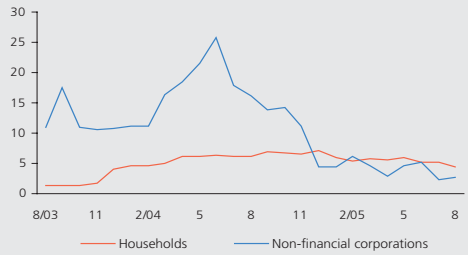


Table III.2
M1 growth slowed, but its share in M2 reached a historical high
(quarterly averages and end-of-month stocks; annual percentage changes)

	IV/04	I/05	II/05	7/05	8/05	Outstanding amount as % of M2 8/05
M1	8.9	8.8	7.0	7.6	6.4	53.5
Currency in circulation	6.7	7.7	8.2	8.5	8.2	13.2
Overnight deposits	9.6	9.1	6.5	7.3	5.9	40.4
M2-M1 (quasi money)	3.6	0.6	3.2	1.8	2.6	46.5
Deposits with agreed maturity	3.6	-1.0	2.1	0.7	0.1	35.4
Dep. bills of exch. and other bonds	21.6	-6.2	-8.4	-0.7	-2.4	6.0
Deposits redeemable at notice	4.4	8.8	10.3	10.7	10.7	10.4
Repurchase agreements	-11.0	-37.4	-46.7	-46.1	27.0	0.7
M2	6.3	4.8	5.1	4.8	4.6	100.0

Table III.3
Lending to corporations and households continued growing
(quarterly averages and end-of-month stocks; annual percentage changes)

	IV/04	I/05	II/05	7/05	8/05	Outstanding amount as % of total loans 8/05
Non-financial corporations	8,0	9,4	11,4	12,7	14,1	51,3
Loans up to 1 year	2,3	2,9	7,3	13,8	15,3	20,7
Loans over 1 year and up to 5 years	17,1	14,8	19,1	14,5	14,1	13,0
Loans over 5 years	9,1	13,9	11,0	10,1	12,8	17,6
Households	32,7	31,5	32,6	33,3	33,4	36,9
Consumer credit	23,9	24,9	31,1	31,2	32,7	7,8
Housing loans	35,3	32,7	34,6	36,1	36,0	25,1
Other loans	34,9	37,2	23,5	21,9	20,2	4,0
Non-monetary financial institutions	-5,7	1,6	1,7	5,3	7,5	11,8
Total loans	12,9	15,1	16,7	18,4	19,6	100,0

III.4.1 Money

Annual M2 growth saw no major changes in Q2 and then slackened to 4.6% in August (see Chart III.16). The annual rate of growth of M2 adjusted for revaluations, exchange rate movements and other effects was 5.4% in August. The slowdown in M2 growth observed since mid-2004 was consistent with GDP growth at current prices (see Chart III.17). This lower growth at a time of faster growth at constant prices was linked with a decline in growth of the GDP deflator, from 3.4% in 2004 Q3 to 0.2% in 2005 Q2.

Turning to the structure of M2, household deposit growth slowed in Q2, primarily as a result of lower growth in gross disposable income and a fall in the saving rate coupled with a modest pick-up in consumption expenditure. Household deposits showed a similar trend in August, recording growth of 4.4% (see Chart III.18). Growth of deposits of non-financial corporations fell to 2.6%, affected by a further worsening of pre-tax profit. As regards its counterparts, the lower M2 growth was accompanied by a further increase in the negative annual growth rate of net credit to the government to -68.7%, which was partly offset by a rise in the annual rate of growth of net foreign assets to 20.7%. The government Eurobond issue played a major role in this respect. The growth in net foreign assets was also linked with the continuing inflow of foreign direct investment. The annual rate of growth of domestic loans to corporations and households picked up in Q2 and reached 21.1% in August.

Growth in the liquid money included in M1 slackened in Q2 and Q3, falling to 6.4% in August (see Table III.2). Overnight deposits by households and non-financial corporations grew more slowly. Conversely, the growth rate of currency in circulation rose, in line with the modest rise in household consumption. The share of M1 in M2 remained high, reaching a historical high of 53.5% in August. This confirms the persisting demand of economic agents for liquid money, affected by the slightly easy interest rate component of the monetary conditions. The opportunity cost of holding liquid money, expressed by the spread between the interest rate on new deposits with an agreed maturity of up to one year (accounting for more than half of new non-overnight deposits) and the rate on overnight deposits, stayed relatively low. Annual growth in quasi money picked up slightly in Q2, but slowed again in August (to 2.6%). Household demand for deposits redeemable at notice of up to three months grew further. By contrast, deposits with agreed maturities saw lower growth.

III.4.2 Credit

Credit growth accelerated further in Q2 and Q3, reaching 19.6% in August 2005 (see Table III.3). This growth was fostered by a further fall in the overall interest rate on new loans to 5.3% in August.

Growth in lending to non-financial corporations increased further to 14.1% in August. Credit to foreign-controlled corporations increased to 18.3%, whereas growth in credit to domestic corporations fell to 12.5% in August after rising in Q2. In addition to the low interest rate, the continuing growth in lending was due to a change in the structure of corporate funds. The second quarter saw a rise in external fund growth and a modest increase in total corporate funds. Conversely, growth in equity capital slackened. The worse internal financing capacity of corporations was linked with the decline in pre-tax profit. Turning to the structure of external funds, borrowing from abroad has fallen this year due to the negative interest rate differential (see Chart III.19). This is particularly visible in foreign-controlled corporations, which previously had primarily used this source of financing.

Both domestic and foreign-controlled corporations preferred short-term loans in Q2. This was due to the favourable interest rates and corporations' efforts to finance their operating needs from external sources. By contrast, the growth of medium-term and long-term loans was lower, although their growth rate in foreign-controlled corporations increased again in August. The pick-up in credit growth was mainly attributable to loans provided to the service sector (i.e. trade, sales, repair and maintenance), manufacture and repair of machinery and manufacture of transport equipment. These industries were also the main contributors to GDP growth on its formation side. By contrast, loans for rental of machinery and equipment showed lower growth, owing to lower interest in leasing than borrowing for car purchases.

Growth in loans to households was again high in Q2 and Q3, reaching 33.4% in August. The shares of housing loans and consumer credit both increased, fostering slightly faster growth in households' consumption expenditure. As regards households' total debt, about 90% of the rise in the absolute volume of loans in Q2 was provided by monetary financial institutions.[10] Demand was highest for mortgage loans. The ratio of total household debt to GDP rose by 0.7 percentage point to about 26% in Q2. The figure for the euro area is roughly 56%. Consumer credit remained the most risky, as it was probably drawn mostly by lower-income households. The debt burden of households was again favourably affected by the low interest rates.

The overall interest rate on new loans fell by 0.3 percentage point to 5.3% in Q2. Interest rates on new loans decreased for both households and corporations. Interest rates on new loans for consumption declined to 15.2% for new overdrafts and 13.1% for consumer credit (see Chart III.20). The temporary decrease in consumer credit rates in April and May was due to a consumer credit special offer at one bank. Interest rates on new loans for consumption in the Czech Republic are, however, higher than in the euro area, owing to a risk surcharge. This surcharge is around 11–13 percentage points in the Czech Republic, compared to about half that level in the euro area. The interest rate on new housing loans fell to 4.4% in the period under review and was similar to that in the euro area. Housing loans are provided to households with higher incomes and are covered by a lien on property. Interest rates on new loans to non-financial corporations were also mostly falling and stood at 3.6% in August (see Chart III.21). These rates were gradually converging to euro area levels, which encouraged non-financial corporations to borrow more from domestic monetary financial institutions and less from abroad.

III.5 DEMAND AND OUTPUT

In 2005 Q2, the accelerating economic growth observed since the start of 2003 reached the highest figures recorded since 1996. Compared to the previous quarter, annual real GDP growth increased by 0.4 percentage point to 5.1%.[11] GDP rose by 4.9% in 2005 H1. According to the CNB's estimates, the economy remained below potential (non-inflation accelerating) output, but the output gap was slightly negative.[12]

A sizeable improvement in the trade balance, due to relatively fast growth in goods exports and flat goods imports, contributed to the high GDP growth rate of above 5%. The better net exports were mainly due to a considerable absolute decrease in imports, which was related to a sizeable weakening of domestic demand. Real

CHART III.19
Growth in domestic loans to corporations was offset by lower borrowing from abroad
(annual flows; CZK billions)

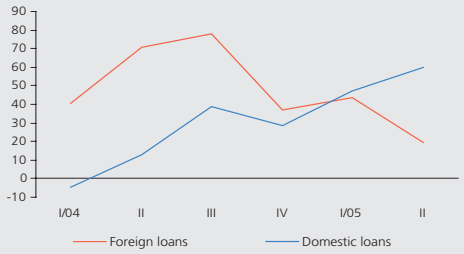


CHART III.20
The interest rate on new housing loans fell somewhat further, supporting household demand for loans
(percentages)

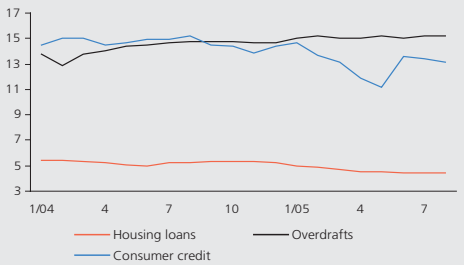


CHART III.21
The interest rate on new loans to non-financial corporations fell further
(percentages)

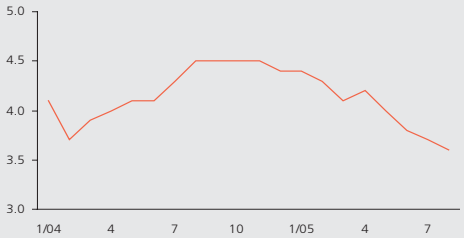


CHART III.22
Economic growth broke through the 5% barrier in 2005 Q2
(annual percentage changes)

[10] Monetary financial institutions include the central bank, resident banks and any other resident monetary financial institutions (money market funds and credit unions).

[11] Together with the 2005 Q2 estimate, the CZSO revised the figures for 2005 Q1. The annual rate of GDP growth for 2005 Q1 was increased from 4.4% to 4.7%.

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

Table III.4
Domestic demand stagnated in 2005 Q2
(annual percentage changes)

	2004 Q1	2004 Q2	2004 Q3	2004 Q4	2005 Q1	2005 Q2
Gross domestic product	4.1	4.5	4.6	4.6	4.7	5.1
Final consumption expenditure	1.8	1.4	0.3	-0.1	0.0	1.8
of which:						
Household consumption	2.8	1.9	1.8	1.5	1.6	2.1
Government consumption	-0.6	-0.1	-3.4	-3.9	-3.5	0.9
Non-profit institutions serving households	8.0	8.2	14.8	15.6	7.2	8.9
Gross capital formation [a]	11.2	10.1	8.1	1.2	-1.0	-4.1
Gross fixed capital formation	7.9	7.4	8.0	7.0	2.9	2.3
Net exports of goods and services (CZK billions)	-43.9	-59.8	-53.8	-61.2	-19.9	-28.6
Imports of goods and services	11.0	27.8	19.3	15.5	10.3	0.1
Exports of goods and services	10.9	29.5	23.6	23.0	17.9	6.9

a) Gross fixed capital formation, change in inventories and net acquisition of valuables.

export growth also moderated, but its dynamics indicated a still strong export performance of the Czech economy in conditions of modest economic growth in its major trading partner countries.[13]

Overall, domestic demand did not contribute to GDP growth in 2005 Q2, as it remained flat at the level of the same period of last year (as in 2005 Q1). Consumer demand increased, but the rise was offset by slower growth or a decrease in the other components of domestic demand. 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 (as it had been at the beginning of the year).

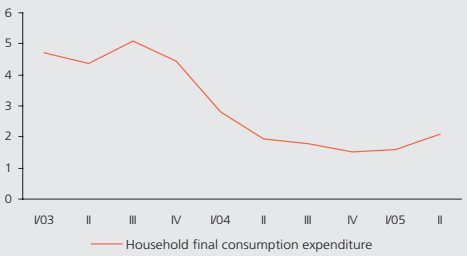
III.5.1 Domestic demand

Aggregate domestic demand recorded a year-on-year stagnation in 2005 Q2. This was due primarily to inventories, additions to which were much lower than in 2004 Q2 as a result of an absolute decline in inventories in business organisations. Overall annual growth in the other components of domestic demand was moderate and did not outweigh the dampening effect of inventories. As regards the structure of domestic demand, only the growth rates for consumer demand and consumption of non-profit institutions increased (to 2.1% and 8.9% respectively). However, the latter is not significant for overall GDP formation. By contrast, a further slowdown in investment demand growth was important for aggregate demand. Government expenditure on final consumption again did not support GDP growth in 2005 Q2.

Consumer demand

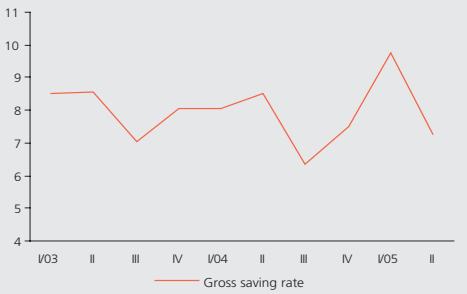
After seven consecutive quarters of annual decline, household consumption growth rebounded in 2005 H1, increasing to 2.1% in Q2. The stronger household demand in Q2 was particularly apparent in clothing and footwear, furniture, audio and video equipment and transport equipment. The upswing in consumer demand was also indicated by the CZSO's household confidence indicator, which in Q2 reached the highest level since its introduction in 1998.

Chart III.23
Consumer demand picked up in 2005 H1
(annual percentage changes)



Growing gross disposable income was the main source of financing of the increased household consumption expenditure. Its rate of growth, however, fell in 2005 Q2 by almost one-half compared to the previous quarter (to 2.3 year on year). Households thus achieved the 3.3% nominal growth in their consumption expenditure through lower saving and higher borrowing. The fact that households used a bigger part of their income in Q2 for consumption was confirmed by an annual decline of CZK 3.9 billion in gross saving from gross disposable income. The gross saving rate subsequently fell to 7.3%. Increased borrowing to finance the higher household consumption expenditure was reported by monetary financial institutions. Consumer credit growth reached double figures in Q2 and accelerated compared to the beginning of the year (for details see section III.4 *Monetary developments*). The evolution of consumer credit suggested that households' increasing propensity to consume partly reflected the easier interest rate component of the monetary conditions.

Chart III.24
Households saved less in 2005 Q2 than in the same period a year earlier
(percentages)



The slower growth in households' gross disposable income in 2005 Q2 was due mainly to a reduction in social benefits and faster growth in current expenditure.[14] Wages and salaries, i.e. the main component of households' income, increased faster than at the beginning of the year (by 5.8% year on year). The year-on-year reduction in social benefits was due to base effects, as pensioners and children had received an extraordinary payment of CZK 6 billion the previous year.

13 The annual moderation in export growth was partly due to base effects.

14 Primarily current income taxes, property taxes, interest paid, social contributions and other current transfers.

Investment demand

Investment demand growth continued to slacken in 2005 Q2, reaching 2.3%. A sharp decline in the annual growth rate of gross fixed capital formation from 7–8% during 2004 to around 2% in 2005 Q2 was caused primarily by decreasing construction investment. This decrease was largely due to base effects connected with increased invoicing prior to the introduction of the higher VAT rate. By contrast, investment in machinery and equipment maintained its relatively high growth rate of 5% and investment in transport equipment rose sharply, by 14.6% year on year. The share of this "technological investment" in total investment was still the largest (nearly two-thirds), while that of construction investment remained slightly below 40%.

The majority of the economic sectors monitored seem to have contributed to the slowdown in investment demand growth in Q2.[15] Very moderate annual growth in capital expenditure in state and local budgets (1.1% at current prices) suggested that government expenditure did not contribute to real investment growth in Q2. In the household sector, housing investment growth slowed (to 2% year on year). This was also indicated by a modest annual rise in the number of completed flats (0.1%) and slower growth in the number of flats under construction compared to the previous quarter (3.9%). At the same time, slowing growth in housing starts, accompanied by a longer time to sale for new flats, indicated a general movement of the supply-demand balance towards equilibrium, with supply already exceeding demand in some segments of this market. The contribution of households' housing investment to the overall investment growth in 2005 Q2 was not significant.[16]

Continuing investment activity in the non-financial corporations sector, which contributes around two-thirds of total investment, accounted for the lion's share of the 2.3% growth in real investment in Q2. The financial performance indicators show that investment in the large non-financial corporations sector grew relatively quickly in 2005 H1.[17] This growth was driven mainly by investment in machinery, apparatus and equipment, whereas construction investment rose only modestly. Within the non-financial corporations sector, foreign-controlled corporations were the largest contributor to investment growth, with a share of almost 70% of total investment by large non-financial corporations.

CHART III.25
Investment demand growth continued to slacken in 2005 Q2
(annual percentage changes)

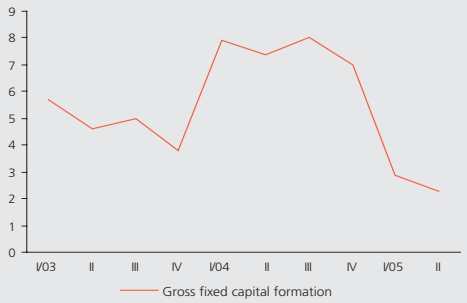
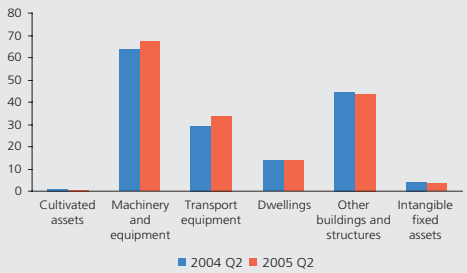


CHART III.26
Investment in machinery and transport equipment rose in particular
(CZK billions; constant prices)



Government demand

General government expenditure on final consumption increased in 2005 Q2 by 0.9% year on year in real terms. This result, however, did not signify a reversal of the previous trend, but was due to a change in methodology.[18] Adjusted for this change, government expenditure on final consumption would have continued to decline in year-on-year terms.

The assessment of government demand is based on an analysis of the performance of the state budget, which represents a substantial part of the government sector. In 2005 Q2, the state budget ended in a deficit of CZK 4.5 billion, an improvement of CZK 37.5 billion compared to the same period last year. This favourable development was due to an extraordinarily high annual increase in revenues (28.2%), which was considerably higher than the increase in expenditure (5.1%).

CHART III.27
Government final consumption expenditure did not contribute to the rise in demand in the economy in 2005 Q2
(annual percentage changes)

15 The CZSO only publishes data on the structure of investment by kind, so the sector analysis of investment is based on partial indicators.

16 Housing investment accounts for roughly 9% of total investment.

17 Newly acquired fixed assets in non-financial corporations with 100 employees or more increased by almost 12% year on year in nominal terms.

18 In Q2, government expenditure included a one-off purchase of fighter aircraft for roughly CZK 11 billion.

The buoyant growth on the revenue side of the state budget reflected above all a sharp rise in both direct and indirect tax collection (25% year on year), although this was mainly due to base effects.[19] Higher non-tax and capital revenues, which grew by 55% year on year, also contributed to the increase in total revenues in 2005 Q2, particularly thanks to the continuing transfer of funds from the 2004 reserves, further inflows of EU funding for domestic projects and compensation payments. State budget expenditure grew more slowly than revenues mainly as a result of a decrease in "other current expenditure" (of 43.1% year on year). Counteracting this was a continuing trend of strong annual growth in the nominal wages of public employees (8.8%). Unlike in the previous quarter, there was also a considerable increase in transfers of funds to regional budgets (of almost 104% year on year) and to budgetary and subsidised organisations (of 14.5%), but these expenditure items do not directly affect government demand. The data adjusted for the aforementioned methodological change thus show that, overall, the government sector did not contribute to demand growth in 2005 Q2.

Chart III.28
Net exports recorded a further year-on-year improvement in 2005 Q2
(CZK billions; constant prices)

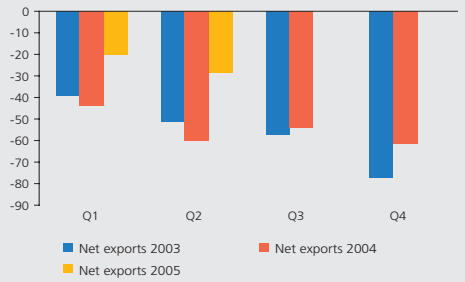
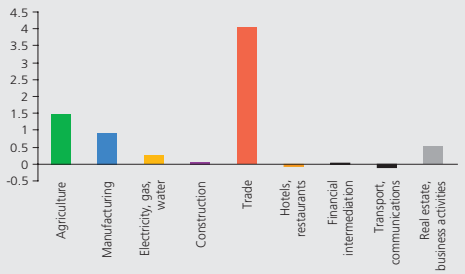


Chart III.29
Exports continued to rise faster than imports in 2005 Q2
(annual percentage changes; constant prices)

Chart III.30
The services sector was the biggest contributor to the GDP growth recorded in 2005 Q2
(contributions in percentage points; selected branches)



III.5.2 Net external demand

In 2005 Q2, the negative balance of net exports of goods and services[20] continued to fall year on year for the fourth consecutive quarter. Negative net exports decreased by more than CZK 30 billion year on year (to CZK -28.6 billion). As in the previous year, their contribution to GDP growth was strongly positive. The improvement in net exports was due exclusively to a still very favourable trade balance, which improved by CZK 32.8 billion year on year, with the deficit changing to a surplus. By contrast, the deficit on the services balance was flat year on year.

The marked improvement in the trade balance occurred despite a significant moderation in foreign trade turnover growth, which was partly due to base effects that occurred after the Czech Republic's accession to the EU. Export growth recorded a significant slowdown (to 6.9% year on year) and imports also grew much slower than in the previous quarter (by 0.1%). Under these circumstances, the lead of export growth over import growth remained fairly large, although it was slightly narrower than in Q1.

Exports and imports of goods were influenced by factors reflecting developments in domestic and external demand. As regards exports of goods, the most important of these factors was the only modest economic growth in the Czech Republic's major trading partner countries. Nevertheless, goods exports grew relatively fast (by 7.6% year on year), indicating a continuing good export performance of the Czech economy. Above all, the shift of production from advanced market economies to the Czech Republic had a positive effect, as did EU accession. After recording annual growth of more than 11% at the beginning of the year, imports of goods were flat in Q2 at the level of the same period of last year. This was due primarily to weakening domestic investment demand. However, imports for intermediate consumption (particularly collaboration imports) and final consumption also slowed.

III.5.3 Output

On the supply side of the economy, gross value added at constant prices rose by 5.5% year on year in 2005 Q2. The services sector was the major contributor to the gross value added growth. As in Q1, however, gross value added within the services

[19] Tax revenues fell as a result of numerous methodological and institutional changes related to the Czech Republic's accession to the EU.

[20] At constant 1995 prices.

sector showed mixed developments. The contribution of the trade sector dominated. Agriculture and industry also recorded significant contributions to gross value added growth. The contributions of other sectors were modest or negative. In industry, gross value added growth accelerated in manufacturing (to 2.7%) and reached 9.2% in electricity, gas and water supply. As at the beginning of the year, creation of gross value added in mining and quarrying fell short of the previous year's level (by 6.5%).

The gross value added growth in industry in 2005 Q2 was accompanied by a moderate rise in the annual growth rate of industrial production to 4.5%. Fast production growth continued in the manufacture of transport equipment (16.5% year on year), manufacture and repair of machinery and equipment (15.6%) and manufacture of coke and refined petroleum products (18.4%). By contrast, production growth decreased in the manufacture of basic metals and fabricated metal products (owing to weaker growth on the iron and steel market) and the manufacture of other non-metallic mineral products. The decline in the textile and clothing industry continued. Production in individual sectors suggested continuing structural changes in industry dependent on the changes in demand for individual products and the ability of companies to maintain their market positions in a strongly competitive environment.

The continuing industrial production growth was still accompanied by buoyant growth in real exports. Total sales in industry rose by 8%, whereas sales from direct exports increased by 11.5% in real terms in Q2, accounting for about one-half of total sales. As in the previous quarters, exports were largely realised by foreign-controlled corporations, as Chart III.32 clearly shows. Growth in exports of transport equipment remained particularly strong, increasing by 19.8% year on year.

After a long-running annual decline, gross value added in construction was flat at the level of the same period a year earlier. By contrast, gross value added in agriculture continued to record extraordinarily rapid growth (46.7%), a trend observed since the beginning of 2005.

Chart III.31
Value added rose in industry amid slightly higher IPI and productivity growth
(annual percentage changes; constant prices)

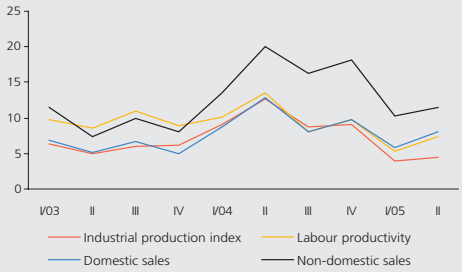
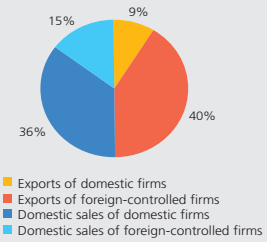


Chart III.32
Exports in industry were due predominantly to foreign-controlled firms
(2005 Q2; shares in total industrial sales - domestic and external - at constant prices)



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

The results of large non-financial corporations in 2005 Q2 confirmed a worsening of the key financial indicators in 2005 H1 in comparison with 2004. Although generation of profit from core activities in large corporations improved in 2005 Q2 compared to the beginning of 2005 (a decline in operating surplus was replaced with growth of 3.3%), overall pre-tax profit fell short of the level of the same period a year earlier (by 4.5%). This was due to a loss from non-core activities amounting to CZK 6 billion. As a result, annual growth in operating surplus was subdued in 2005 H1 (0.4%) and total profit fell by 2.8% year on year.

The considerably slower growth in profit from core activities in Q2 and the whole of 2005 H1 in comparison with 2004[22] was due to several factors. In particular, rapid growth in the prices of imported energy-producing materials continued. Unlike in the previous year, the prices of domestic energy resources also increased significantly.[23] Although prices of numerous other imported higher value added inputs decreased year on year, the material cost-output ratio increased noticeably

Table III.5
Profit generation decreased overall in 2005 Q2, while profit from core activities rose only slightly
(annual percentage changes)

	2005 Q2	
	Organisations, total	Industry
Income, total	9.7	11.1
Output, total	9.8	10.9
Expenses, total	10.8	11.9
of which: cost of sales	11.7	12.9
personnel costs [a]	7.5	6.8
depreciation	3.7	4.7
Book value added	5.4	5.4
Pre-tax profit	-4.5	2.4
Net operating surplus	3.3	4.0

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

21 Assessment based on figures for non-financial corporations with 100 employees or more, all industries.
22 In 2004 as a whole, pre-tax profit rose by 33.5% year on year and net operating surplus increased by 27.1%.
23 Coal price growth did not pick up until 2004 Q4.

Table III.6
The profitability indicators worsened
(percentages; percentage points; CZK thousands)

	2005 Q2 in percent		Change in perc. points against 2004 Q2	
	Organisations, total	Industry	Organisations, total	Industry
Profit-expenses ratio (profit/expenses)	6.50	7.82	-1.00	-0.73
Profit-equity ratio (profit/equity)	4.00	4.48	-0.40	-0.21
Profit-sales ratio (profit/sales)	6.76	7.99	-0.93	-
Asset turnover (sales/assets)	30.08	28.91	0.56	-
Material cost-output ratio	71.28	74.65	1.19	1.33
Personnel cost-output ratio	14.21	11.12	-0.31	-0.42
Ratio of wage costs to value added	49.49	43.86	0.93	0.59
	CZK thousands per month		annual percentage changes	
Book value added per employee	55.27	61.19	4.40	4.5

compared to the previous year. The material cost-output ratio had risen annually by 0.59 percentage point in the whole of 2004, whereas its growth in 2005 Q2 was roughly twice as high. At the same time, these adverse effects were depressed to a lesser extent than in the previous year by a fall in the personnel cost-output ratio (of 0.31 percentage point year on year). From the exporters' point of view, the evolution of the terms of trade was also unfavourable. The decline in their positive year-on-year values, which turned into a decrease in Q2, meant that corporations had less leeway to offset the rising prices of energy inputs through export prices. At the same time, strong competition on the domestic market, bolstered by the mostly falling prices of imported final products, also limited the scope for pass-through of the higher energy input prices into domestic prices. Under these circumstances, 2005 Q2 saw a year-on-year fall in return on equity (of 0.4 percentage point), the profit-expenses ratio (of 1 percentage point) and return on sales.

As regards ownership structure, the impact of these factors on the performance of corporations was mixed. Pre-tax profit generation rose only in public corporations in 2005 Q2 and H1. In private corporations and foreign-controlled corporations it was lower than a year earlier. Most industries recorded falling profits, with only one-quarter posting higher earnings than a year earlier. Profit growth was fastest in mining of energy-producing materials and the electricity, gas and water supply industry, which recorded significant price increases. By contrast, profit generation in the major export industries fell year on year in 2005 H1.

Chart 1 (Box)
The large increase in profit in 1998–2004 was achieved amid a lower rise in equity
(year 1998 = 100)

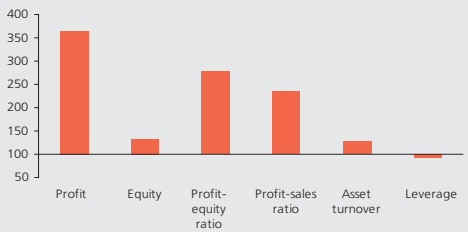
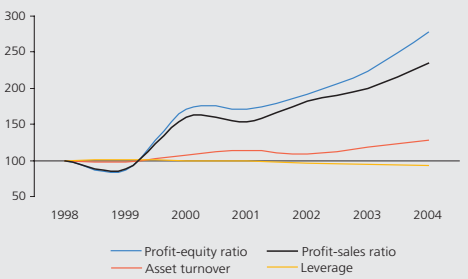


Chart 2 (Box)
The profit-equity ratio is gradually increasing
(year 1998 = 100)



BOX 2
The performance of large non-financial corporations 1998-2004

From the analytical point of view, the year-on-year decrease in pre-tax profit in 2005 H1 elicits two questions. First, how efficient was the relatively strong growth in equity in previous years? Second, what caused the decrease in profit at a time of very buoyant economic growth in 2005 H1, and, in particular, did the decrease reflect temporary factors or was it also linked with the efficiency of the investment realised?

Financial efficiency can be analysed using the CZSO's data on the financial performance of large corporations (with 100 employees or more) in 1998-2004 and a quantitative analysis of the increase in profit by means of Du Pont analysis, which identifies the manner in which the profit increased using the following variables:

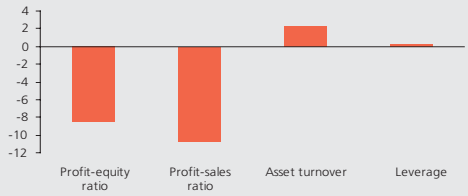
$$Z = R_1 / R_0 \ * \ O_1 / O_0 \ * \ P_1 / P_0 \ * \ K$$

Z - profit increase, R - return on sales (profit/sales), O - asset turnover (sales/assets), P - leverage (total capital/equity), K - equity increase

The analysis reveals that the considerable increase in profit was achieved amid a much lower rise in equity in 1998–2004. This indicates that the increase in equity (including tangible investment) contributed to the reported increase in profit to a lesser extent, and that more efficient utilisation of equity and external capital was the major factor. This is confirmed by the other components of the profit analysis, which express the financial efficiency of non-financial corporations measured using profitability indicators. Equity grew approximately by one-third in the period under review, but the rise in return on equity was roughly sixfold. Return on sales was the dominating factor behind the growth in return on equity, increasing by about 130%. The increase in asset turnover was much lower (see Chart 1). From the longer-term perspective, return on equity in non-financial corporations is thus recording an upward trend, as Chart 2 clearly shows.

The favourable evolution of profitability indicates that profit was generated amid higher capital productivity, due mainly to investment in new production equipment realised primarily with the aid of foreign capital. Although the economy went through a phase of buoyant growth in 2005 H1, more detailed analyses of the profit generation suggest that the year-on-year decrease in profit was primarily a result of a rise in the prices of energy inputs and worse terms of trade. However, the decrease did not fundamentally negate the long-term upward trend in capital utilisation efficiency.

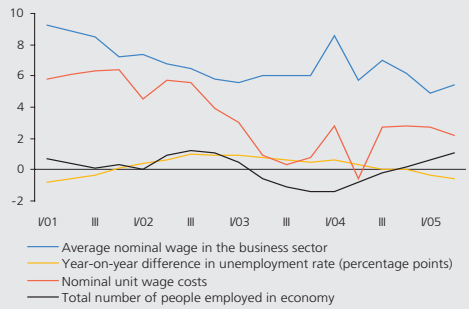
CHART 3 (BOX)
The worsening profit-equity ratio in 2005 H1 was linked with cost factors
(annual percentage changes)



III.6 THE LABOUR MARKET

The developments on the labour market in 2005 Q2 and Q3 were consistent with the current phase of buoyant economic growth and the inflow of foreign direct investment. These factors paved the way for an increase in the number of persons employed in the secondary and tertiary sectors and consequently fostered a slight reduction in the unemployment rate. However, relatively high structural unemployment persisted, as indicated in particular by the high long-term unemployment rate. The rise in corporations' demand for labour did not have a noticeable effect on average wages in the business sector, as pressures for a reduction in the personnel cost-output ratio emerged due to the strong competition. Overall, average nominal wage growth moderated to the lowest levels observed since the establishment of the Czech Republic. Annual growth in nominal unit labour costs at the micro-level of the whole economy slowed in Q2. Productivity in industry measured by real sales continued to grow faster than average real wages, and nominal unit costs fell year on year.

CHART III.33
The steady decline in the unemployment rate continued
(annual percentage changes; percentage points)



III.6.1 Employment and unemployment

The favourable tendencies in employment from the previous year and the beginning of 2005 continued into 2005 Q2. Further growth in the number of employed persons, resulting in an annual increase of 1.1% in employment in 2005 Q2,[24] suggested a continuing upturn in labour demand in the economy. As in the previous quarters, the number of employed increased only in the category of employees,[25] which account for around 84% of the total number of employed persons. Their annual growth strengthened further in 2005 Q2, reaching 1.9% (i.e. 75,000 people). However, the number of entrepreneurs declined further (by 3.1% year on year), although to a lesser extent than at the beginning of 2005. This was largely associated with an improving supply of steady employment opportunities.

The continuing employment growth was related to the persisting stable economic growth in the Czech economy and the benefits of foreign direct investment. This was evidenced by high growth in employment in foreign-controlled corporations, which exceeded 10% in Q2 and was the largest at the level of corporations in terms of ownership.[26] Their influence was noticeable in manufacturing, where employment increased in Q2 by 12,800 people year on year according to LFS figures, and in some other sectors. With regard to sectors, employment continued to grow in the secondary and tertiary sectors, which were the main "sources" of economic growth in this period. In Q2, employment increased year on year by 33,900 and 28,600 people in the secondary and tertiary sectors respectively.

CHART III.34
Employment continued to rise in 2005 Q2
(annual percentage changes)

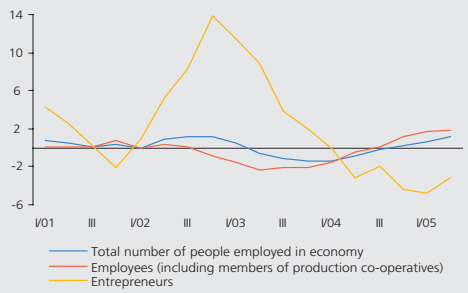
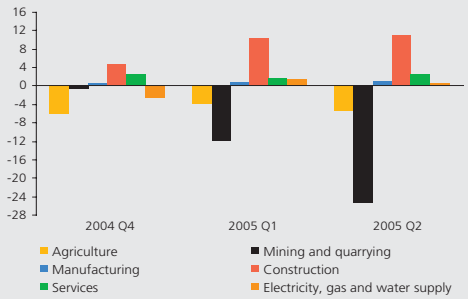


CHART III.35
Demand for labour increased chiefly in construction, manufacturing and services
(annual percentage changes; 2005 Q2; source: LFS)



24 This rise meant an increase in employment of 50,100 people.
25 Including members of production co-operatives.
26 As measured by the CZSO figures on employment in corporations with 20 employees or more.

Chart III.36
Creation of vacancies was flat
(seasonally adjusted numbers in thousands)

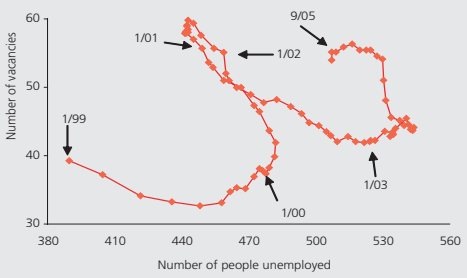


Chart III.37
Structural unemployment was relatively high, and the share of the long-term unemployed in total unemployment decreased only slightly
(percentages; source: LFS)

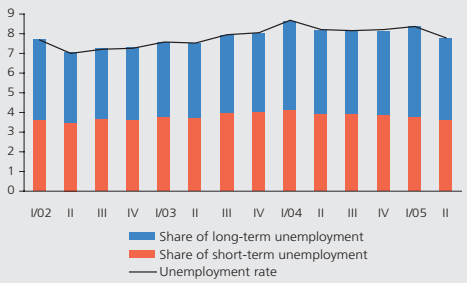


Table III.7
Average nominal wage growth slowed further
(annual percentage changes)

	2004 Q1	2004 Q2	2004 Q3	2004 Q4	2004	2005 Q1	2005 Q2
Average wage in monitored organisations							
nominal	8.8	4.2	7.3	6.3	6.6	5.8	5.4
real	6.4	1.6	4.0	3.1	3.7	4.1	3.7
Average wage in business sector							
nominal	8.6	5.7	7.0	6.2	6.9	4.9	5.4
real	6.2	3.0	3.7	3.0	4.0	3.2	3.7
Average wage in non-business sector							
nominal	9.6	-0.5	8.3	6.4	5.7	8.9	5.4
real	7.1	-3.0	4.9	3.2	2.8	7.2	3.7
Whole-economy labour productivity	4.4	4.8	4.2	4.5	4.5	4.1	4.2
Nominal unit wage costs	2.8	-0.6	2.7	2.8	1.9	2.7	2.2

Nevertheless, the increase in employment was not across the board in nature in Q2. A number of sectors showed a decline in employment as a result of strong competition exerting downward pressure on costs or of factors on the demand side. Sectors with increasing employment prevailed overall in the secondary sector, with the largest rise being recorded for the number of employees in construction for the third consecutive quarter (by 35,000 people in Q2, particularly in corporations engaged in infrastructure development). In the tertiary sector, the largest rises in employment were recorded in education, public administration, defence, social security and health care. Some segments, however, showed a decline.

However, the increasing demand for labour, which fostered employment growth in some sectors, did not manifest itself in the figures on vacancies registered by labour offices. Their annual growth remained unchanged, staying roughly at the level of the previous quarter (around 10,000 vacancies). Nor did the unemployment indicators signal any significant improvement compared with the previous quarter. Although the annual decline in the number of unemployed persons (of 26,800) and in the unemployment rate (to 9.6%)[27] increased in September (see Chart III.33), part of this decline was due to exclusions of job applicants as a result of heavier penalties applied under the new Act on Employment.[28] Thus, demand for labour was not yet sufficiently large to help significantly reduce the registered unemployment rate. This conclusion was also supported by the slope of Beveridge curve as shown in Chart III.36.

The gradual cyclical easing of the situation on the labour market has not yet fostered a marked narrowing of the regional, skills and professional gaps between the supply of, and demand for, labour. Despite many measures, there has been no significant decrease in the share of the long-term unemployed (53.3%) in the total number of unemployed.

III.6.2 Wages and productivity

The downward trend in average nominal wage growth in the national economy, observed since the start of 2004, continued into 2005 Q2. The annual growth rate (5.4%) was one of the lowest since the establishment of the Czech Republic; only in 2004 Q2 had a slower growth rate of average nominal wages been recorded (4.2%). Slower wage growth was recorded for both the business and non-business sectors.

In 2005 Q2, nominal wages in the two monitored sectors grew at the same rate (5.4%). Real wage growth was slower at 3.7%, owing to annual inflation.

Wages in the national economy are primarily affected by the business sector, which accounts for around 80% of the set of all monitored organisations. Compared to the non-business sector, wages in the business sector had shown smoother development in the previous quarters. Wage growth was affected by the strongly competitive environment, which curbed possible price growth. Compared to 2004, the pressures for subdued wage growth in the business sector strengthened further in the first half of 2005, as profit generation worsened as a result of increasing costs of energy inputs and some other effects.[29] Corporations tried to cope with these negative effects by reducing their wage cost-output ratios, hence conditions were

[27] Under the new methodology, the unemployment rate stood at 8.8% in September.

[28] For example, job applicants who refuse to cooperate with labour offices, start a suitable job, etc. are excluded from the register of unemployed persons.

[29] For details see section III.5.4 *Financial performance of non-financial corporations*. Large non-financial corporations recorded an annual decline in pre-tax profit of 4.5% in 2005 Q2.

not created for any major pick-up in nominal wage growth in the business sector, despite the continuing relatively fast economic growth and increasing employment.

The trend in the non-business sector was "jumpy", reflecting the implementation of related government measures and the financial capacities of the state budget. This was also evidenced by the uneven wage trend within this sector. As in 2004, the marked rise in wages was due to large pay increases for some public sector professions.[30] At the same time, the "thirteenth" and "fourteenth" paycheques were cancelled.

Annual growth in whole-economy productivity has been stable above 4% since the start of 2004 (see Chart III.38). The stable productivity growth is chiefly attributable to industry, where labour productivity[31] has been showing relatively fast growth with slight fluctuations for several quarters. In Q2 alone, it was up 7.6% on a year earlier. This rise was fostered by the launching of new production capacities, accompanied by an increase in production primarily for export, and by the rationalisation of employment in a number of sectors.

The subdued wage growth and the stable rate of growth of whole-economy productivity affected the relationship between wage and productivity variables at the micro-level of the economy as a whole. Annual growth in nominal unit labour costs, which are an important indicator of potential inflationary pressures from this area, slowed by 0.5 percentage point to 2.2% in Q2. At the same time, whole-economy productivity grew faster than average real wages. Within the individual sectors, the personnel cost-output ratio in industry continued to show favourable developments. Labour productivity in industry has been growing faster than the average real wage for several consecutive quarters, and nominal unit wage costs have been decreasing for three years. In 2005 Q2 alone, nominal unit wage costs decreased by 2.6% year on year, which meant a further labour cost reduction and a rise in the competitiveness of producers on domestic and foreign markets. The still sizeable annual growth in nominal unit labour 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.

Chart III.38
Whole-economy productivity growth stayed above 4%
(annual percentage changes)

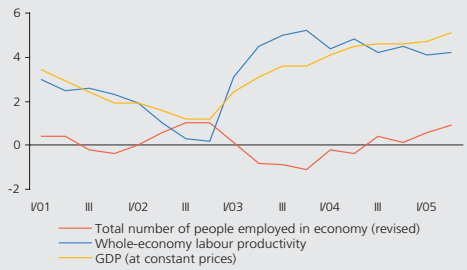
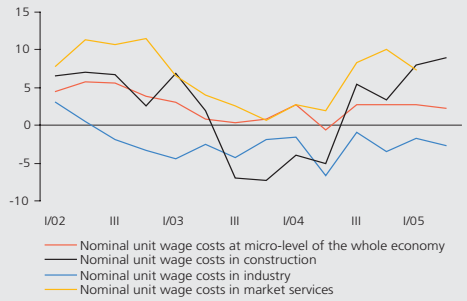


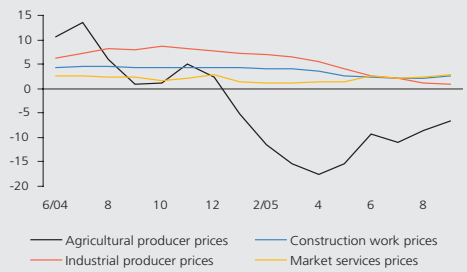
Chart III.39
Growth in nominal unit wage costs eased further in 2005 Q2
(annual percentage changes; selected branches)



III.7 IMPORT PRICES AND PRODUCER PRICES

Import prices in 2005 Q3 indicated renewed external cost pressures associated with the rise in prices of energy-producing materials on world markets. Although their effect on import prices was dampened by the annual appreciation of the koruna's exchange rate, import prices of mineral fuels saw fast growth. In most other import categories, however, commodity prices decreased year on year owing to low external inflation and the appreciation of the koruna's exchange rate. As a result, the overall increase in import prices in the first two months of Q3 was moderate. The high oil prices have not yet passed through significantly into industrial producer prices. In contrast, producer price inflation in manufacturing decreased further, primarily in connection with the unwinding of the impact of high prices of metals and metal products. Fast growth in prices of energy (coal, electricity) for the corporate sector continued. Agricultural producer prices continued to fall significantly year on year. Construction work prices and prices of market services saw a modest pick up in inflation.

Chart III.40
Industrial producer price inflation continued to moderate in 2005 Q3
(annual percentage changes)



30 Salaries in the police service, the prison service, fire brigades and the customs administration increased in January 2005.

31 Calculated from sales at constant prices.

III.7.1 Import prices

Import prices, which are one of the most important inflation factors in the Czech economy, indicated an upturn in inflation at the end of 2005 Q2 and in the first two months of 2005 Q3. However, after five months of slight annual decline, this inflation was only moderate, not exceeding 2% (1.7% in July and 0.2% in August).

The upturn in import price inflation was chiefly associated with continuing sizeable year-on-year growth in energy-producing material prices on world markets, which reached extraordinary figures fluctuating around 50% in 2005 Q2 and Q3.[32] Nevertheless, due to considerably lower year-on-year appreciation of the koruna-dollar exchange rate in June and the first two months of Q3,[33] their effect on domestic prices was dampened by the exchange rate to a lesser extent than in the previous quarters, with import price inflation thus accelerating to levels well above 30% (32.6% in August).

Import prices of energy-producing materials showed the largest annual growth within the import price index, as world prices of metals and, subsequently, import prices of other raw materials confirmed a continuing downward trend in inflation in Q3. Metal prices on world markets rose at roughly half the rate of 2004 H2 (12.1% year on year in August) and prices of other non-energy-producing materials did not show extraordinary growth, either.[34] As a result, import prices of non-energy-producing materials, "corrected" by the koruna-dollar exchange rate, recorded a year-on-year decline (of 1.1%) in August following a previous slight increase. Food prices showed very mixed developments on world markets. Overall, food import prices (excluding beverages and tobacco) continued to fall year on year.

Unlike raw material, prices of imported higher-value-added products continued to fall year on year in Q3. This different price trend was observed mainly for the high-weight categories of machinery and transport equipment and miscellaneous manufactured articles, where relatively low foreign prices in major trading partner countries, when converted into korunas, were bolstered by relatively higher annual appreciation of the koruna exchange rate (around 6% in the case of the koruna-euro exchange rate). The mixed developments in the structure of import prices subsequently implied different impacts on producer and consumer prices (see section II.1 *Past inflation developments*).

III.7.2 Producer prices

Industrial producer prices

The downward trend in annual industrial producer price inflation, which started in 2004 H2, continued into 2005 Q3. According to the latest available CZSO figures, annual industrial producer price inflation was moderate, dropping to 1% in September. As in the previous three quarters, the slowdown in industrial producer price inflation was chiefly associated with the weakening external and some domestic cost pressures in the strongly competitive environment.

Chart III.41
Rapid growth in prices of imported energy-producing materials fostered an upswing in import price inflation
(annual percentage changes; contributions in percentage points)

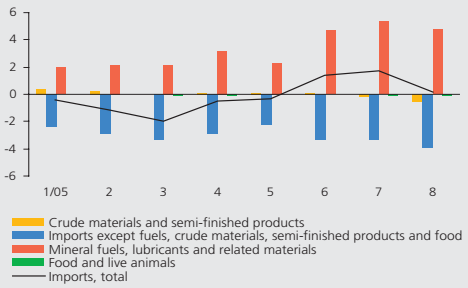
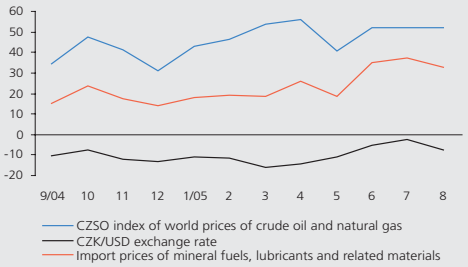


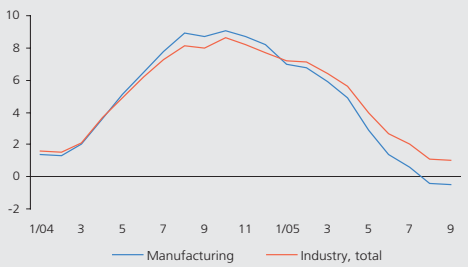
Chart III.42
The impacts of world prices of energy-producing materials on import prices were dampened by appreciation of the koruna-dollar exchange rate to lesser extent than in previous quarters
(annual percentage changes)



Tab. III.8
Import prices of higher value added products continued falling year on year
(annual percentage changes)

	3/05	4/05	5/05	6/05	7/05	8/05
Imports, total	-1.9	-0.5	-0.3	1.4	1.7	0.2
Food and live animals	-0.9	-1.6	-0.6	-0.4	-1.9	-1.5
Beverages and tobacco	1.6	3.1	1.6	2.3	3.5	1.6
Crude materials except fuels	2.2	3.2	0.7	1.2	1.2	-1.1
Mineral fuels and related products	18.6	25.7	18.4	34.8	37.4	32.6
Animal and vegetable oils	-7.9	-9.3	-10.0	-11.8	-13.8	-13.8
Chemicals and related products	-2.8	-1.8	-0.3	-0.8	-1.2	-3.1
Manufactured goods classified by material	-0.6	-0.3	0.3	0.0	-1.1	-2.5
Machinery and transport equipment	-6.4	-5.5	-4.3	-3.5	-2.5	-4.0
Miscellaneous manufactured articles	-7.6	-7.5	-6.7	-7.5	-7.6	-8.5

Chart III.43
The downward trend in industrial producer price inflation in manufacturing continued into 2005 Q3
(annual percentage changes)



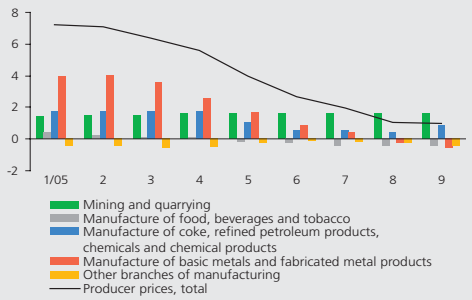
[32] According to the CZSO's world price index, prices of oil and natural gas rose by 52.3% and 51.1% respectively year on year in August 2005.

[33] The koruna-dollar exchange rate appreciated by 12.8%, 10.1% and 5.9% year on year in 2005 Q1, Q2 and Q3 respectively. The figures for the koruna-euro exchange rate over the same period were as follows: 8.6%, 5.9% and 6.0%.

[34] Prices of raw materials in certain subcategories continued to fall year on year (textiles, leather, wood).

As Chart III.44 shows, this slowdown in industrial producer price inflation (PPI) in 2005 Q3 was mostly 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. According to the latest CZSO figures for September, the annual growth in producer prices of basic metals and fabricated metal products declined by 9.8 percentage points to -4.1% compared to the end of the previous quarter. As a consequence of this change, their contribution to PPI growth decreased by around 1.4 percentage points in September as compared to June, turning negative (see Chart III.44). Hence, producer prices in primary metal processing accounted for around 80% of the total slowdown in industrial producer price inflation in the given period.

CHART III.44
The metal-processing industry was the biggest contributor to the slowdown in industrial producer price inflation
(annual percentage changes; contributions in percentage points)

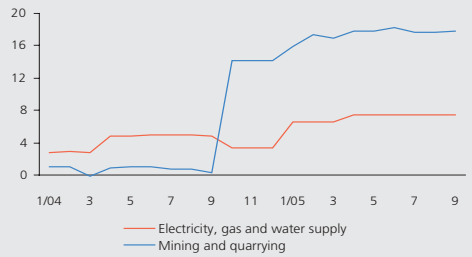


The slower industrial producer price inflation in Q3 was also due to prices in the food industry, where the year-on-year decline in prices deepened to 2.3% in September, owing to an ongoing sharp decline in the crop product prices of domestic primary producers. Producer prices in other sectors of manufacturing for the most part also fell short of the level of the same period a year earlier.

Price growth in the manufacture of coke and refined petroleum products moderated (to 8.1%), only to pick up markedly again to 16.4% in September. Underlying these changes were mixed developments in producer prices in the manufacture of coke and refined petroleum products.[35] The August slowdown in inflation seemed to be a result of slower growth in prices in the manufacture of coke due to declining demand for metal products. In contrast, the more pronounced annual inflation in September reflected fast growth in import prices of oil.

Non-manufacturing industries maintained high inflation. In Q3, the fastest growth was recorded by producer prices in mining and quarrying, owing to a rise in coal prices (of 17.8% year on year in September). Their development reflected cost effects as well as a rise in prices of alternative energy sources. Producer price inflation in the electricity, gas and water supply industry was the same as at the end of the previous quarter (7.4% year on year) and was brought about by changes to prices of electricity for the corporate sector.

CHART III.45
Industrial producer price inflation remained high only in power generation and mining of energy-producing materials
(annual percentage changes)

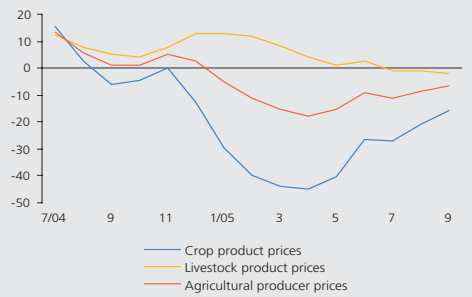


The structural trends in industrial producer prices thus remained mixed. Surging prices of both imported and domestic energy inputs pushed up production costs, but pass-through into domestic producer prices was observed only in sectors standing at the initial stages of the product vertical. A year-on-year decline in prices prevailed in categories of production with a higher degree of processing (or higher value added), while a smaller number of sectors saw only a modest rise in prices. The causes of the very weak or zero transmission of the rapidly rising oil prices to domestic producer prices on both the supply and demand side are specified in detail in sections III.5.4 *Financial performance of non-financial corporations* and II.2 *Past inflation developments*.

Agricultural producer prices

Agricultural producer prices recorded another large year-on-year fall in 2005 Q3 (6.7% in September). As in the previous quarters, this was mainly due to crop products, prices of which remained well below the same period a year earlier (15.6% in September; see Chart III.46).[36] However, a more detailed look at the crop product price index structure reveals that the annual fall was largely due to cereal prices.

CHART III.46
The sharp decline in agricultural producer prices was again linked with the evolution of crop product prices
(annual percentage changes)



[35] In this case, the CZSO only publishes aggregate data for the manufacture of coke and refined petroleum products, not for the individual subcategories.

[36] The smaller annual decline was largely due to base effects.

The main reason behind the persisting low prices of cereals and some other crop products[37] was the record harvest in 2004, which changed the supply-demand relationship in the agricultural commodity market. Although the harvest in 2005 was poorer than in 2004 according to preliminary CZSO data, it was above the average for the past ten years. 2005 Q3 again saw no elimination of the surplus from the domestic market which would boost the record low domestic prices, which for cereals are around 15% below the EU intervention price. Also important for crop product prices was the pronounced ongoing annual appreciation of the koruna-euro exchange rate, which 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 decline in prices of other items, in particular potatoes, in Q3.

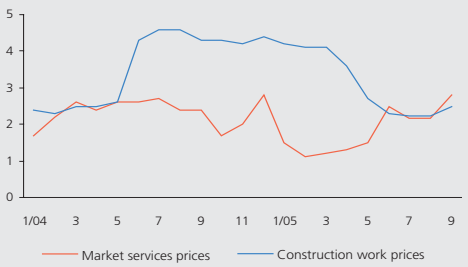
In 2005 Q3, prices of the higher-weight items of the overall livestock product index again reflected the unwinding of the one-off effect of the Czech Republic's accession to the EU, when opportunities to export livestock products to EU countries had improved sharply. The relatively fast growth of these prices at the beginning of this year was replaced in Q2 by a rapid slowdown to 2.4% in June and a year-on-year fall in prices since July (of 2.2% in September).

Other producer prices

Prices in other categories of the production sector picked up slightly in September compared to June. In the first two months of 2005 Q3, construction work prices indicated a halt to the downward trend in their growth (to 2.2% in August) observed since the beginning of 2005. This trend seems to have been linked primarily with considerably slower annual growth in prices of materials and products consumed in the construction industry (to 0.9% in August), which was related to the aforementioned trend in metal prices on world markets. In September, annual construction work inflation accelerated, reaching 2.5%.

Annual growth in prices of market services for the corporate sector also picked up in 2005 Q3 compared to the end of the previous quarter (from 2.5% in June to 2.8% in September). However, the structural trends in prices of market services remained very mixed. In 2005 Q3, price growth accelerated in the category of business services (to 2.5% in September). Other categories of market services for the corporate sector were flat or saw a slight slowdown in price growth in September compared to the end of Q2. The fastest price growth was recorded for sewerage collection charges (5.8% year on year) and postal and telecommunications services (4.2%).

CHART III.47
Construction work and market services price inflation rose in 2005 Q3
(annual percentage changes)



[37] Prices of cereals decreased by 20.4% year on year in September.

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 present reference scenario is based on the September data from this publication, which reveals that the assessment of external effects on Czech economic growth shifted moderately in the inflationary direction overall compared to the July forecast.[38]

Consensus Forecasts made an upward revision to oil prices during Q3. This led to expectations of higher external inflation and growing interest rates abroad. The current forecast assumes a Ural crude oil price of USD 57 a barrel in 2005 Q4, then a decline below USD 51 a barrel in 2006 Q3 and oil price stability over the rest of 2006 and in 2007. Owing to the further appreciation of the dollar in 2005 Q3, the assumption regarding the euro-dollar exchange rate up to the end of 2007 has also been changed towards a stronger dollar. The assumption of a gradual strengthening of the euro remains unchanged, however. Expected one-year euro area interest rates[39] have shifted upwards over the entire forecast horizon. The reference scenario thus assumes stability of the 1Y EURIBOR nominal interest rate at 2.2% up to mid-2006 and subsequent modest growth.

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

	IV/05	I/06	II/06	III/06	IV/06	I/07	II/07	III/07
Ural crude oil prices (USD/barrel)	56.8	53.5	51.5	50.6	50.5	50.6	50.6	50.6
GDP in Germany (annual, in per cent)	1.3	1.3	1.1	1.4	1.4	1.5	1.5	1.5
Producer price inflation in Germany (annual, in per cent)	3.4	2.6	2.1	1.6	2.1	2.0	1.5	1.3
Consumer price inflation in Germany (annual, in per cent)	1.7	1.5	1.6	1.6	2.1	2.2	1.6	1.2
Nominal USD/EUR exchange rate	1.236	1.243	1.251	1.263	1.275	1.283	1.288	1.291
1Y EURIBOR	2.2	2.2	2.2	2.3	2.4	2.5	2.5	2.6

The September Consensus Forecasts outlook for GDP growth in Germany, which is used in the CNB's forecasting system to proxy for developments in the Czech Republic's major trading partner countries, was essentially unchanged from the previous forecast. The forecast for German GDP growth is 0.9% in 2005 and 1.3% in 2006. However, expectations regarding consumer price inflation have been revised upwards, to 1.8% in 2005 and 1.7% in 2006. Expected growth in industrial producer prices has also been raised. The increase is more significant for 2005 (for which the estimate has been raised to 4.1%); for 2006 a growth rate of 2.1% is expected.

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, are an important input to the forecast. From the economic point of view, no major shift in the outlook for public finances occurred compared to the July forecast. The upward revisions to the deficits for 2005 and 2006 are not due to macroeconomic factors. The increase in the deficit for 2005 is mainly a result of the transfer from 2004 of a write-off of some receivables. The CNB's estimate of the general government deficit for 2005 under ESA 95 methodology has been revised to 3.6% of GDP, and the expected deficit for 2006 has been slightly increased to 3.0% of GDP. These higher deficits, however, will not generate demand pressures, so the forecast expects fiscal policy to have a roughly neutral effect on the dynamics of economic activity in 2005 and 2006.

Assumptions regarding the equilibrium values of key macroeconomic variables also play an important role for the message of the forecast. This is because the starting

[38] The predictions of the October Consensus Forecasts were published after the CNB forecast had been completed and so have not been incorporated into it.

[39] Since the Consensus Forecasts publication does not include predictions for 1Y EURIBOR rates, which are inputs to the CNB forecast, the expected future evolution of these rates is derived from the euro yield curves as of the September Consensus Forecasts survey date.

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 determines the fundamental orientation of the forecast. The variables that affect 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. This analysis draws on the linkages between these variables as perceived by the CNB's forecasting system. Box 3 describes the method used to estimate potential output and compares it with an alternative methodology using the production function.

BOX 3
Potential output in the CNB's forecasting system

In the CNB's forecasting system, potential (or equilibrium) output is taken to mean the level of real output at which real economic activity does not generate upward or downward pressures on inflation. Thus, the estimate of equilibrium output is not associated with any specific level of inflation, but is only linked with the absence of pressures for a change in inflation.

Like the equilibrium levels of other macroeconomic variables, the equilibrium level of output is not an observable and measurable variable. A whole range of different methods can be used to estimate equilibrium output. The CNB's main method of estimating potential output is closely linked with its definition. The estimate uses a multi-equation model, which has the advantage that it includes other information on the labour market and inflation in addition to data directly concerning output. In this model, potential output, the non-accelerating inflation rate of unemployment, the effect of monetary policy and several other parameters are determined simultaneously, which enables their interactions to be taken into account. For example, if inflation accelerates without the presence of a supply shock and a fiscal impulse, it is likely that monetary policy was easy in the past and, as a result, there was an excess of demand over production. A recursive algorithm known as the Kalman filter is used to generate the estimate in the model.

As an alternative approach to determining potential output, the CNB also uses an estimate based on the production function. This looks exclusively at the supply side of the economy, identifying factors of current and future growth in real economic activity on the supply side (technological progress, labour and capital). However, this method of estimating potential output is affected by the problem of low robustness of the estimate of the final values using the univariate Hodrick–Prescott filter.

Charts 1 and 2 compare the estimates of potential output obtained using these two methods. Compared to the Kalman filter, the production function approach leads to a slightly lower estimate of the level of potential output, but to roughly the same estimate of the current growth rate of potential output, at 4%. The October forecast projects the same rate of growth going forward.

Chart 1 (Box)
The production function approach leads to a slightly lower estimate of the potential output level
(CZK billions; constant prices)

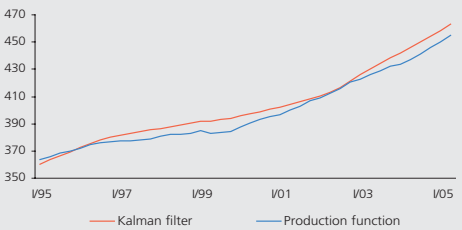
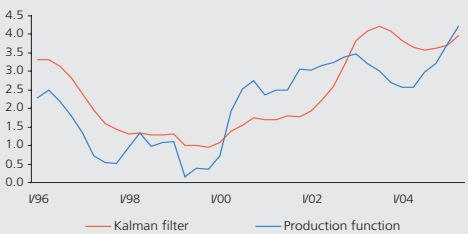


Chart 2 (Box)
The estimate of the current growth rate of potential output is roughly the same for both approaches
(annual percentage changes; constant prices)



Since the preparation of the July forecast, no information has emerged leading to a substantial 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 expected appreciation of the real

equilibrium exchange rate is decreasing gradually from the current annual rate of around 2.5% to 2% in 2007. The forecast expects potential output (i.e. the non-accelerating inflation rate of output) to grow by around 4%, which is consistent with recent economic developments.

The information on economic activity published since the July forecast confirmed the previous forecasts of a slowdown in the gradual closing of the output gap. This is due to the tighter exchange rate component of the real monetary conditions at the end of 2004 and at the beginning of 2005 and the still weak external demand. The output gap is currently somewhat narrower than forecasted, mainly because of the faster-than-expected GDP growth in 2005 H1. However, output remains below its potential.

The high rate of economic growth in 2005 Q2 was due mainly to net exports. Despite a slowdown caused by the tightening of the real exchange rate and the absence of recovery abroad, exports maintained their relatively robust growth, owing to new export-oriented facilities. Imports were flat amid growth in all components of consumption and an annual decline in gross capital formation. Household consumption confirmed its moderate upward tendency and was accompanied by a reduction in the saving rate. Government consumption also rose. A further decline in inventories was the primary cause of the fall in gross investment; demand for fixed investment reflected the ongoing decline in construction investment and continued to record only modest annual growth.

Consumer prices were affected in H2 by world prices of energy, especially oil and natural gas, which generated a marked rise in fuel and natural gas prices in the Czech Republic. Other cost factors have had an anti-inflationary effect on consumer prices so far in 2005. Import prices excluding energy as well as agricultural producer prices have declined year on year. The position of the economy in the business cycle also acted in the anti-inflationary direction. Consumer prices rose slightly slower than expected.

Overall, the current real monetary conditions, which affect the future course of the business cycle, can be characterised as neutral to very slightly easy. The effect of the exchange rate component tightened somewhat as a result of the appreciation of the real exchange rate. The interest rate component is still regarded as slightly easy.

IV.3 THE MESSAGE OF THE FORECAST

The current forecast partially changes the view of the projected economic growth in 2005 and 2006, the structure of that growth, and the output gap. Underlying this shift are foreign cost factors and GDP growth in the first half of this year. Although the output gap narrowed slightly in Q3, the combination of a tighter exchange rate component of the real monetary conditions, a more restrictive effect of fiscal policy on economic activity and persisting low external demand will cause it to widen again over the coming quarters. Nevertheless, an easing of the monetary conditions in 2006 will foster a change to renewed gradual closure. In 2005 and 2006, the aforementioned evolution of the output gap corresponds to a gradual slowdown in real GDP growth from 4.8% in 2005 to 3.9% in 2006.

As a result of the slight increase in employment and the gradually prevailing effect of the easy interest rate component, household consumption will pick up further over the coming quarters. However, its growth rate will be lower that forecasted in July because of lower-than-expected real gross disposable income growth due to slower growth in wages and salaries in 2005 and 2006 and higher inflation in

Chart IV.1
The output gap will remain open over the next two years
(annual percentage changes; percentages of GDP; seasonally adjusted)

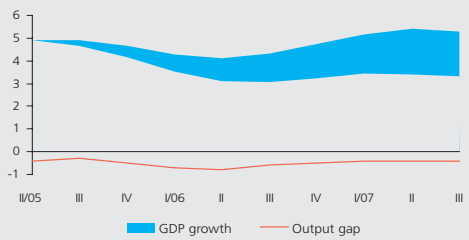


Table IV.2
The rate of growth of real disposable income will fall
(annual percentage changes)

	2005	2006
Real disposable income of households	2.3	0.6
Unemployment rate (in per cent)	9.8	9.5
Labour productivity	3.8	3.0
Current account deficit (ratio to GDP in per cent)	-2.9	-2.1
M2	5.1	5.0

2006. This will result in household consumption growth of 2.6% in 2005 and 2.8% in 2006, accompanied by a decline in the gross saving rate. As regards the expenditure components of GDP, the revised forecast for the public budgets has partly affected the prediction for government consumption, in particular for 2006, when a higher contribution is expected from fixed asset consumption of the public sector. Annual real growth of public sector final consumption expenditure will reach 2% in 2005 and 1.5% in 2006.

Table IV.3

Economic growth will be driven by net exports and investment

(annual percentage changes)

	2005	2006
Gross domestic product	4.9	3.9
Household consumption	2.6	2.8
Government consumption	2.0	1.5
Gross fixed capital formation	2.7	5.7
Imports of goods and services	3.2	8.9
Exports of goods and services	9.7	9.8
Net exports of goods and services (in CZK bn)	-113.7	-107.3

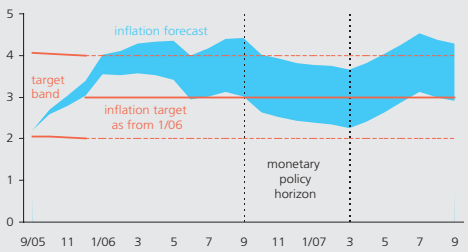
Gross fixed capital formation will be adversely affected at the end of this year by slower exports and a tighter real exchange rate and will grow at broadly the same pace as in the first half of the year. Nevertheless, public sector capital expenditure is a major factor as regards the fulfilment of the forecast. Fixed investment growth will pick up slightly during 2006 thanks to rising investment demand in export-oriented sectors and a slight easing of real interest rates. Satisfactory corporate financial results, a persisting rise in lending and the inflow of actually allocated foreign direct investment will further boost this pick-up. The annual growth rate of investment demand will remain just below 3% in 2005, whereas in 2006 it should increase to 6%.

The lower export growth in this year is primarily due to the unwinding of the level effect connected with EU entry and the tightening of the exchange rate component of the monetary conditions at the turn of 2005. The effect of the real exchange rate will gradually ease next year. The recovery in external demand will act in the same direction. At the same time, the growth trend in export performance, which is attributable to FDI inflow and subsequent changes on the supply side of the economy, will continue. In 2006, the average export growth rate will be thus maintained at the previous year's level, standing around 10%. Imports usually copy exports to a large extent, as exports include a high proportion of imported intermediate products. But imports are also affected by the level and structure of domestic demand. The expected lower capital formation in this year will make imports grow by around 3% despite the tighter real exchange rate. Nevertheless, 2006 will see a recovery in gross investment and a renewed convergence of import and export growth. The aforementioned development will generate a considerably lower real net export deficit in 2005 and 2006.

Chart IV.2

The inflation forecast is just above the point inflation target at the monetary policy horizon

(annual change in CPI; percentages)



Broad stability of the exchange rate at its current level is expected for 2005 and 2006.

The expected inflation path is determined by the combined demand-pull pressures resulting from real economic activity, imported inflation and other exogenous factors. As a result of the cost shock in 2005 H2 and the revision of the predictions for regulated prices, the inflation forecast has been raised over the entire forecast horizon. At the monetary policy horizon, the inflation forecast is just above the inflation target.

Table IV.4

Growth of inflation will be driven by regulated prices and fuel prices

(annual percentage changes)

	IV/05	I/06	II/06	III/06	IV/06	I/07	II/07	III/07
Annual consumer price inflation	2.9	3.8	3.8	3.7	3.2	3.0	3.3	3.7
Breakdown into contributions:								
regulated prices	8.4	9.1	8.7	6.9	4.6	3.5	3.4	4.3
indirect taxes (contributions in p.p.)	0.2	0.4	0.4	0.6	0.6	0.4	0.7	0.6
food prices, excluding effects of indirect taxes	0.5	0.9	1.3	1.6	1.7	1.8	1.9	2.3
fuel prices, excluding effects of indirect taxes	18.3	25.9	12.3	1.1	-4.2	-3.2	-2.4	-1.4
adjusted inflation excluding fuels, excluding effects of indirect taxes	0.7	1.3	1.7	2.3	2.7	3.0	3.0	3.1

By comparison with the July forecast, the annual headline inflation figure expected for 2005 Q4 has been raised from 2.3% to 2.9%. The forecast for the end of 2006 is annual inflation of 3.2%. The prediction has been increased in 2005 primarily for regulated prices and fuel prices and in 2006 for regulated prices and adjusted inflation excluding fuels. Despite the deferred demand-pull inflationary pressures, adjusted inflation will gradually accelerate, owing mainly to pass-through of the second-round effects of the growth in energy prices in the form of increased inflation expectations among economic agents, although only partial pass-through of the higher oil prices into other price categories is assumed. Renewed growth in import prices excluding energy prices will foster an increase in adjusted inflation in 2006. The next round of increases in indirect taxes and a pick-up in food price inflation will also have an inflationary effect. These factors will also act in 2007, when they will be bolstered by further changes to indirect taxes (the final stage of

the harmonisation changes to excise duties on tobacco products). Consistent with the forecast is a gradual rise in interest rates.

During the preparation of the current forecast, two alternative scenarios were discussed: higher oil prices and a more restrictive fiscal policy.

The first alternative assumes an immediate and permanent increase in oil prices to USD 75 a barrel. The simulation examines the active influence of central banks and the effects on cross exchange rates and external demand. The external developments are subsequently incorporated into the baseline scenario of the forecast. The higher oil prices, coupled with modest growth in external prices, would increase import prices and, consequently, domestic inflation. The depreciation pressure stemming from higher foreign interest rates would act in the same direction. In contrast, the fall in external demand would have anti-inflationary effects over the medium term. In this alternative scenario, the growth in interest rates would be higher than in the baseline scenario, amid a wider output gap and higher inflation.

The second alternative scenario assumes a more restrictive fiscal policy than in the baseline scenario. This reflects the high degree of uncertainty regarding the state budget performance this year. The alternative examines an increase of CZK 17 billion in additions to reserve funds, i.e. a further decline in the budget deficit of 0.6% of GDP. The smaller contribution of fiscal policy to real growth this year would be reflected in a wider output gap, lower inflation and slightly lower domestic interest rates.

IV.4 EXPECTATIONS OF ECONOMIC AGENTS

The inflation outturns expected by financial market participants increased slightly. Analysts expect inflation to rise in the near term, but not to exceed the CNB's inflation target of 3%. Rising oil prices and administered prices (gas, rents, excise duty on tobacco, electricity) are the main upside risks to inflation, according to the analysts, i.e. inflation should be driven chiefly by cost factors. The expected appreciation of the koruna remains the main downside risk. Moreover, strong competition will prevent full pass-through of the higher prices of raw materials and energy into consumer prices. The inflation expectations of corporations rose slightly, too. A larger 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 and corporations are below the CNB's inflation target of 3% at this horizon, too.

Expected interest rates were almost unchanged in the period under review. Only the short end of the yield curve saw a slight upward shift. The interest rate path consistent with the aforementioned CNB forecast was above the path expected by 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	6/05	7/05	8/05	9/05
Consumer price index					
1Y horizon:					
Financial market	2.8	2.3	2.4	2.5	2.5
Corporations	3.2	2.7			2.8
Households	1.5	3.8			5.2
3Y horizon:					
Financial market	2.8	2.5	2.5	2.6	2.5
Corporations	2.7	3.1			2.8
Households	1.8	6.0			5.7
1Y PRIBOR					
1Y horizon:					
Financial market	3.4	2.3	2.3	2.4	2.3

MINUTES OF THE BOARD MEETING ON 25 AUGUST 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), P. Řežábek (Chief Executive Director)

The Board discussed the August situation report, which analysed the new information and assessed the risks associated with the fulfilment of the July forecast.

The July annual inflation figure of 1.7% had been 0.3 percentage point lower than predicted by the current forecast. The deviation had been due to slower growth in adjusted inflation excluding fuels and a faster fall in food prices. The increase in administered prices had also been rather less than forecasted. Conversely, fuel prices had risen more quickly. The latest data concerning industrial producer prices and import prices suggested slightly higher figures by comparison with the forecast. Agricultural producer prices in July had been pretty much in line with the assumptions of the forecast.

The newly published figures on supply side developments and foreign trade indicated no major risks to the fulfilment of the forecast, which expects second-quarter GDP growth close to 4%. The lower-than-forecasted investment activity might have been offset by better balance of trade figures. Unemployment was in line with the forecast, but the wage developments in industry and construction suggested slightly lower wage growth in the enterprise sector.

After the presentation of the situation report, the Board discussed the risks to the fulfilment of the July forecast. There was broad agreement that the risks could be viewed as moderate and balanced. The Board's discussion covered several topics.

The high oil prices and the expected evolution of administered prices constituted a short-term inflationary factor. It was also said that in the medium term there might be some transmission of cost pressures to prices via wages. On the other hand, it was said that the high oil prices could pose a risk to external economic growth. Likewise, higher growth in administered prices could lead to weakening domestic demand in other segments of the domestic economy.

The Board discussed the evolution of investment and its potential implications for the economy going forward. Lower investment growth relative to the July forecast could be expected in the second quarter, chiefly as a result of a slowdown in private investment. Public sector investment was showing relatively dynamic growth. Weaker private investment coupled with a lower inflow of foreign direct investment could indicate a weakening of the supply side of the economy. The hypothesis was expressed that the weakening of private investment may be associated with rising competition in the global economy and a gradual loss in the Czech Republic's relative competitiveness. It was repeatedly mentioned that the future investment attractiveness of the Czech economy was linked, among other things, with the development of the domestic business environment and the degree and manner of regulation by the state.

Considerable attention was paid to the balance of payments, which was repeatedly described as an important factor for the formation of exchange rate expectations. In the past, those expectations had often been derived from current account developments. However, the financial account was steadily growing in relevance. Its evolution would be increasingly dependent on reinvestment. The Board agreed that no fundamental appreciation pressures on the exchange rate were apparent from the balance of payments outlook.

The Board discussed the issue of drawing of EU funds. The current figures indicated a very low level of drawing. However, attention was drawn to the existence of a lag between the start of project implementation and the drawing of EU money, which might be distorting the true situation.

The Board's discussion also covered the issue of wage bargaining. Concerns were raised that the expected growth in administered prices of gas and electricity might affect the wage bargaining for next year. The wage bargaining process was to take place in a new framework this year, as legal extensions of sectoral collective agreements had entered into force. It was said repeatedly that the CNB would closely monitor the wage bargaining process.

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 29 SEPTEMBER 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 was presented with the September situation report assessing the new information and risks associated with the fulfilment of the July 2005 macroeconomic forecast.

As in the previous month, annual consumer price inflation had been 1.7% in August. Just like in July, annual inflation had been 0.3 percentage point lower than the latest forecast, as the higher-than-expected growth in fuel prices had not offset the downward deviations. Adjusted inflation excluding fuels had been lower than predicted, as had growth in administered prices, owing to the delayed impact of higher excise duties on tobacco products. Agricultural and industrial producer price inflation had been in line with the forecast, while import prices had been higher than forecasted thanks chiefly to oil prices.

GDP growth in the second quarter of 2005 had been higher by comparison with the current forecast, thanks mainly to better-than-expected net exports. Year-on-year household consumption growth had also been faster. Conversely, gross fixed capital formation had been lower than forecasted. A revision of the previous GDP growth data had been published at the same time as the new figure. This revision had partly changed the view regarding the growth in last few quarters. Prior to the revision, the data from early part of 2004 had indicated a gradual slowdown in quarter-on-quarter growth, whereas according to the new figures the economy had been showing an accelerating growth trend since 2002. Unemployment was broadly in line with the forecast, but wage growth in the enterprise sector was slower.

After the presentation of the situation report, the Board discussed the risks to the fulfilment of the July forecast. The Board agreed that there were risks in both directions and that they were more pronounced than in the past. The monetary conditions were in line with the forecast, the rather tighter exchange rate component thereof being balanced by slightly easier interest rate conditions.

Prices of energy – most notably oil and natural gas – were viewed as the main upside risks to inflation. While the July forecast predicted some fall in oil prices over the coming quarters, the Board felt that there was a major risk of the high prices of energy-producing materials persisting in the longer run. The degree of pass-through of the cost shock into inflation expectations and wages is a monetary policy risk. Some of the board members also pointed out the rise in inflation in the main European and world economies and mentioned the risk of transmission of the related inflation pressures into the domestic economy.

The exchange rate is fostering lower-than-forecasted inflation, having been rather stronger than assumed in the forecast over the past quarter. Another downside risk is the recent evolution of inflation, even in the context of the faster-than-expected growth of the economy. The low industrial producer price inflation was also emphasised in the discussion of the downside risks. However, it was also said that this might be a case of compensation of the past high growth of these prices. It was repeatedly mentioned that the low money supply growth suggested very weak inflation pressures. Against this, though, it was said that lending growth was fairly robust in all segments, and it was also mentioned that in the short run monetary aggregates are an unreliable indicator of future inflation.

The Board also dealt in detail with the significance of the newly published GDP growth figures. The board members agreed that the deviation of the new figures from the prediction required in-depth analysis. A detailed examination of the GDP data, including the linkage between inflation and the output gap, would form part of the new October macroeconomic forecast. It was pointed out that one of the factors underlying the high annual GDP growth was a large deterioration in the terms of trade. The internal consistency of the current data was discussed, and the opinion was expressed that a downward revision of these figures was more possible than in the past. The uncertainties were concentrated mainly around the measurement of net exports and their deflators. In addition, the Board discussed the possible structural discrepancies between data on GDP resources and expenditure, and attention was likewise drawn to the weak link with events on the labour market, where part of

the statistical improvement may have been associated with administrative changes rather than economic factors. Attention was also drawn to the low corporate investment in the global economy, which was persisting despite the low level of real interest rates. This poses a major risk to domestic investment demand as well.

The Board also discussed the relatively fast growth in loans. The opinion was expressed that the combination of relatively fast economic growth, the expansion in lending to households, the rise in corporate loans and the low real interest rates was raising concerns going forward. This notwithstanding, it was said repeatedly that the time structure of lending was balanced, as the volume of long-term corporate loans was also rising and the financial sector should be capable of adequately assessing the risks. The view was expressed that while mortgage lending was being stimulated by the current monetary policy settings, the link with monetary policy rates was weaker in the case of consumer credit, owing to the high level of rates in this segment.

The Board said that the state budget was developing very favourably, thanks mainly to high tax revenues. It was said repeatedly that budget policy was nonetheless too easy given the current economic developments. There was broad agreement that the future fiscal path is a major source of uncertainty for the CNB's decision-making.

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 27 OCTOBER 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 discussed the 10th situation report, containing the new macroeconomic forecast.

The inflation forecast had shifted upwards compared to the July forecast, primarily because of a cost shock in the form of rising energy prices and a revision of the prediction for regulated prices. The growth in fuel prices was much higher than the July forecast had expected. The first-round effects of the rise in energy prices would disappear at the monetary policy horizon, but the cost pressures would generate a rise in inflation expectations. Monetary policy responded within the forecast to the second-round effects of the rising energy prices. As a consequence of these second-round effects, inflation would remain higher than in the July forecast and fluctuate just above the point inflation target at the monetary policy horizon.

The demand climate, however, remained modestly anti-inflationary. The negative output gap was rather narrower than the July forecast had predicted, reflecting the buoyant GDP growth in the first half of this year. This economic growth had been fostered chiefly by an improvement in net exports, although the rate of growth of both exports and imports had slowed markedly. The forecast expected the output gap to widen in the immediate future, owing to the combined effect of energy rice growth, a tighter real exchange rate, more restrictive fiscal policy and persisting low external demand. Closure of the output gap was pushed back beyond 2007. After this year's high GDP growth, the forecast expected a slightly lower rate of growth in 2007.

Consistent with the October forecast was a gradual rise in interest rates.

After the presentation of the situation report, the Board discussed the new forecast and the risks thereto. It started off by addressing the issue of the second-round effects of the rise in energy prices. It was said that the higher energy prices were having a double impact. On the one hand they were fostering a rise in inflation, and on the other hand they were reducing disposable incomes. The uncertainty surrounding the intensity of the second-round effects of the rise in oil prices on other price categories was viewed as considerable. Given the uncertainty regarding the intensity of the price spillovers, which would not emerge until later on, the opinion was expressed that it would be better to increase rates in line with the forecast now and thus avoid the risk of a need for faster growth in rates to a higher level in the future. It was also said that the alternative scenarios assuming less intensive spillover of the price growth also implied a rise in rates. The Board agreed that real interest rates were falling as a result of the rise in inflation. Some of the members regarded this, in the context of buoyant economic growth, as an argument for raising nominal interest rates. The view was also expressed that an increase in rates would only be appropriate if the cost shock generated a longer-term shift in inflation towards the inflation target.

The Board then turned to the issue of forming inflation expectations. The view was expressed that successful stabilisation of cost shocks is determined by the ability of central banks to anchor inflation expectations. It was noted that given the credibility of monetary policy, the rise in inflation expectations would not necessarily be significant. Attention was also drawn to the experience with the historically low impact of cost shocks and tax changes on inflation. The opinion was expressed that the rise in prices would not be disproportionately reflected in wage bargaining. By contrast, some of the members regarded upward pressure on wage growth as possible, given the corporate profitability and high economic growth.

The Board went on to discuss the demand pressures in the Czech economy. It agreed that it currently observed no such pressures in the economy. The opinion was expressed that the forecasted structure of economic growth was not generating demand-pull inflation. Some of the members were not expecting any major upswing in demand in the EU Member States, which would lead to demand pressures from abroad. It was pointed out that the growth in prices of some raw materials had yet to pass through to consumer prices, hence there was potential pressure here for a rise in prices.

In the light of past developments, the Board was not expecting a demand impulse from fiscal policy this year, but there was considerable uncertainty regarding developments next year. Some of the members viewed continuing

fiscal restriction as likely. Others voiced concerns about a possible more expansive policy. This argument was supported, among other things, by the fact that fiscal policy in 2005 had not been restrictive intentionally.

The Board continued with a discussion of the global context of domestic inflation. It was said that the higher oil price was a result of growing demand for energy, especially in Asian economies, and was not necessarily transitory in nature. In this regard, it was said that economies today are much better prepared for an oil shock than they were in the 1970s. It was also pointed out that demand for cheap goods from Asian countries, which was depressing prices and contributing significantly to the low-inflation and low-nominal-interest-rate environment worldwide, was a symmetric phenomenon vis-a-vis the current inflation-accelerating excess demand for oil. It was also said that if the long-term inflation trend was higher, and if the low domestic rates were a temporary reaction to the past nominal appreciation of the koruna and the negative output gap, then a rise in rates was the appropriate monetary policy response.

After discussing the situation report, the Board decided by a majority vote to raise the two-week repo rate by 0.25 percentage point to 2% with effect from 31 October 2005. At the same time it decided to increase the discount rate and Lombard rate by the same amount, to 1% and 3% respectively. Four members voted in favour of this decision, and three members voted for leaving rates unchanged.

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	1.7	1.7	2.2			
Regulated prices	2.9	2.9	2.9	3.1	4.0	5.8	6.6	6.8	6.8			
(contribution to consumer price inflation)	*0.61*	*0.60*	*0.61*	*0.66*	*0.83*	*1.21*	*1.38*	*1.41*	*1.41*			
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*	*-0.02*	*-0.03*	*-0.06*			
Net inflation	0.9	0.9	0.7	0.8	0.6	0.7	0.4	0.4	1.1			
(contribution to consumer price inflation)	*0.72*	*0.75*	*0.59*	*0.68*	*0.46*	*0.53*	*0.35*	*0.35*	*0.89*			
of which: prices of food, beverages and tobacco	0.4	0.6	0.4	-0.1	-0.1	0.2	-0.6	-0.6	-0.2			
(contribution to consumer price inflation)	*0.11*	*0.17*	*0.12*	*-0.02*	*-0.03*	*0.04*	*-0.15*	*-0.17*	*-0.05*			
adjusted inflation	1.1	1.1	0.9	1.3	0.9	0.9	0.9	1.0	1.8			
(contribution to consumer price inflation)	*0.61*	*0.59*	*0.47*	*0.69*	*0.49*	*0.48*	*0.50*	*0.52*	*0.94*			
Inflation rate (annual moving average)	2.8	2.7	2.6	2.6	2.5	2.4	2.2	2.1	2.0			

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	0.3	0.0	-0.3			
Regulated prices	2.2	0.2	0.1	-0.2	0.1	1.8	0.8	0.0	0.0			
(contribution to consumer price inflation)	*0.48*	*0.04*	*0.01*	*-0.05*	*0.02*	*0.39*	*0.16*	*0.00*	*0.01*			
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*	*0.00*	*0.00*	*0.00*			
Net inflation	0.3	0.2	-0.1	0.1	0.2	0.2	0.2	0.0	-0.3			
(contribution to consumer price inflation)	*0.26*	*0.13*	*-0.06*	*0.11*	*0.15*	*0.19*	*0.17*	*-0.01*	*-0.26*			
of which: prices of food, beverages and tobacco	0.5	0.0	-0.1	-0.2	0.5	0.2	-1.3	-0.7	-0.2			
(contribution to consumer price inflation)	*0.12*	*0.01*	*-0.02*	*-0.06*	*0.12*	*0.05*	*-0.33*	*-0.17*	*-0.04*			
adjusted inflation	0.3	0.2	-0.1	0.3	0.1	0.3	0.9	0.3	-0.4			
(contribution to consumer price inflation)	*0.14*	*0.11*	*-0.04*	*0.17*	*0.03*	*0.14*	*0.50*	*0.16*	*-0.21*			

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	15.4	15.4	15.1				14.7
Food and non-alcoholic beverages	197.6	6.9	6.9	6.8	6.6	7.3	7.5	5.6	4.6	4.4				6.3
Alcoholic beverages and tobacco	79.2	12.6	12.8	12.7	12.3	12.3	12.5	12.4	12.4	12.3				12.5
Clothing and footwear	56.9	-17.2	-18.2	-18.4	-18.1	-18.1	-18.3	-19.6	-20.7	-20.6				-18.8
Housing, water, electricity, gas and other fuels	236.4	34.7	34.9	35.1	34.9	34.9	35.0	35.6	35.7	35.8				35.2
Furnishings, household equipment and routine maintenance of the house	67.9	-5.2	-5.4	-5.5	-5.7	-5.8	-5.9	-6.1	-6.2	-6.4				-5.8
Health	14.3	25.5	26.1	26.7	27.3	29.1	30.1	30.2	30.4	31.0				28.5
Transport	101.4	3.9	3.7	4.1	6.8	6.9	7.8	9.5	9.6	13.6				7.3
Communications	22.5	21.0	20.1	20.1	20.0	19.9	38.6	39.0	39.0	38.2				28.4
Recreation and culture	95.5	9.8	11.4	10.1	8.9	9.4	10.1	15.8	18.1	10.1				11.5
Education	4.5	14.9	15.6	15.8	15.8	15.8	15.6	15.6	15.6	19.5				16.0
Hotels, cafés and restaurants	74.2	20.4	21.0	21.2	21.5	21.4	21.5	21.2	21.2	22.4				21.3
Miscellaneous goods and services	49.5	20.3	20.9	20.9	20.9	20.8	20.7	20.7	20.6	20.7				20.7

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 9	2004 12	2005 3	2005 6	2005 9
1. Food and non-alcoholic beverages	197.6	7.9	2.1	5.7	4.7	6.6	6.8	7.5	4.4
- tradables	197.6	7.9	2.1	5.7	4.7	6.6	6.8	7.5	4.4
2. Alcoholic beverages and tobacco	79.2	5.4	7.1	7.8	12.3	11.6	12.7	12.5	12.3
- tradables	79.2	5.4	7.1	7.8	12.3	11.6	12.7	12.5	12.3
3. Clothing and footwear	56.9	-3.9	-7.7	-11.9	-15.8	-14.6	-18.4	-18.3	-20.6
- nontradables	1.4	13.0	18.3	21.1	34.9	35.9	36.9	37.1	37.6
- tradables	55.5	-4.3	-8.4	-12.7	-17.1	-15.9	-19.8	-19.7	-22.1
4. Housing, water, electricity, gas and other fuels	236.4	19.0	24.3	26.6	30.5	32.2	35.1	35.0	35.8
- nontradables	226.1	19.7	25.2	27.5	31.4	33.2	36.2	36.1	36.9
- tradables	10.3	2.7	4.0	5.9	11.3	10.7	11.9	10.6	12.0
5. Furnishings, household equipment and routine maintenance of the house	67.9	-0.4	-1.0	-3.0	-4.5	-4.9	-5.5	-5.9	-6.4
- nontradables	2.9	7.5	9.9	12.3	16.2	16.8	15.7	16.5	17.1
- tradables	65.0	-0.8	-1.5	-3.7	-5.4	-5.9	-6.5	-6.9	-7.5
6. Health	14.3	8.4	12.8	16.4	21.7	20.6	26.7	30.1	31.0
- nontradables	11.0	10.1	15.4	19.9	26.7	25.2	33.2	37.4	38.5
- tradables	3.3	2.7	4.4	5.1	5.5	5.6	5.7	6.4	6.4
7. Transport	101.4	3.4	4.1	3.6	6.4	5.0	4.1	7.8	13.6
- nontradables	27.4	11.7	16.0	18.4	22.9	23.0	24.4	24.7	26.3
- tradables	74.0	0.3	-0.3	-1.9	0.3	-1.6	-3.4	1.5	8.9
8. Communications	22.5	5.7	8.2	7.2	19.6	21.0	20.1	38.6	38.2
- nontradables	21.0	8.5	2.1	2.3	14.9	16.6	15.8	46.8	46.5
- tradables	1.5	-34.7	95.9	77.5	86.7	83.6	82.0	-79.0	-80.8
9. Recreation and culture	95.5	7.2	7.2	6.1	8.9	7.9	10.1	10.1	10.1
- nontradables	60.4	14.3	16.2	16.7	22.7	21.2	25.0	26.2	26.8
- tradables	35.1	-5.0	-8.3	-12.1	-14.8	-15.0	-15.5	-17.7	-18.7
10. Education	4.5	6.8	11.3	12.0	17.9	18.1	15.8	15.6	19.5
- nontradables	4.5	6.8	11.3	12.0	17.9	18.1	15.8	15.6	19.5
11. Hotels, cafés and restaurants	74.2	5.9	8.7	10.8	18.8	19.6	21.2	21.5	22.4
- nontradables	74.2	5.9	8.7	10.8	18.8	19.6	21.2	21.5	22.4
12. Miscellaneous goods and services	49.5	8.7	11.9	15.2	20.2	20.3	20.9	20.7	20.7
- nontradables	22.0	17.5	25.8	36.4	48.1	48.4	50.3	50.7	51.2
- tradables	27.5	1.7	0.8	-1.7	-2.0	-2.2	-2.6	-3.2	-3.6
Household consumer prices, total	1,000.0	8.4	9.0	10.1	12.6	13.2	14.1	15.0	15.1
Tradables	549.1	2.9	0.6	0.7	0.6	0.9	0.4	0.6	0.1
- food	276.8	7.2	3.5	6.3	6.9	8.0	8.5	8.9	6.7
- others	272.3	-1.5	-2.4	-5.0	-5.8	-6.3	-7.8	-7.8	-6.5
Nontradables	450.9	15.2	19.2	21.6	27.3	28.2	30.8	32.6	33.4
- others	271.2	11.5	16.5	19.4	26.7	26.9	28.9	29.5	33.1
- regulated	179.7	20.6	23.2	24.9	28.2	30.3	33.7	37.3	33.8

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	3.8
7/05	2.4	—	—
8/05	2.5	—	—
9/05	2.5	2.8	5.2

Source: CNB statistical survey

Table 5

HARMONISED INDEX OF CONSUMER PRICES

annual percentage changes

	2001	2002	2003	2004	2005
	12	12	12	12	9
Belgium	2.0	1.3	1.7	1.9	3.0
Denmark	2.1	2.6	1.2	1.0	2.4
Finland	2.3	1.7	1.2	0.1	1.1
France	1.4	2.2	2.4	2.3	2.4
Ireland	4.4	4.6	2.9	2.4	2.8
Italy	2.2	3.0	2.5	2.4	2.2
Luxembourg	0.9	2.8	2.4	3.5	4.7
Germany	1.4	1.1	1.1	2.2	2.6
Netherlands	5.1	3.2	1.6	1.2	1.7
Portugal	3.9	4.0	2.3	2.6	2.7
Austria	1.8	1.7	1.3	2.5	2.6
Greece	3.5	3.5	3.1	3.1	3.8
Spain	2.5	4.0	2.7	3.3	3.8
Sweden	3.2	1.7	1.8	0.9	1.1
United Kingdom	1.0	1.7	1.3	1.6	2.5
European Union	1.9	2.2	1.8	2.2	2.5
Czech Republic	3.9	0.1	1.0	2.5	2.0

Source: Eurostat

Table 6

MONETARY SURVEY					position at month-end in CZK billions
	2001	2002	2003	2004	2005
	12	12	12	12	8
Total assets	1,596.0	1,651.8	1,766.1	1,844.1	1,920.2
Net external assets (NEAs)	800.6	926.1	821.5	863.3	1,080.1
NEAs of CNB	__	715.6	687.5	634.1	728.3
NEAs of OMFIs	__	210.5	134.0	229.3	351.8
Net domestic assets	795.4	725.8	944.5	980.8	840.1
Domestic loans	1,011.9	940.0	1,145.6	1,147.0	1,092.1
Net credit to government (NCG) (including securities)	__	215.8	354.0	257.5	84.1
NCG to central government (including securities)	__	260.4	408.7	312.4	162.8
NCG to other government (including securities)	__	-44.6	-54.8	-54.9	-78.6
Loans to corporations and households					
(excluding securities)	775.4	724.2	791.6	889.4	1,008.0
Loans to corporations (excluding securities)	636.1	542.7	554.1	574.2	636.5
Loans to households (excluding securities)	139.3	181.5	237.5	315.2	371.5
Other net items (including securities and capital)	-216.5	-214.3	-201.1	-166.2	-252.0
Holdings of securities	__	18.5	16.6	18.8	19.0
Issued securities	__	-48.6	-51.6	-75.0	-98.8
Liabilities					
Monetary aggregate M2	1,596.0	1,651.8	1,766.1	1,844.1	1,920.2
Monetary aggregate M1	583.6	787.7	902.8	962.3	1,028.1
Currency in circulation	180.4	197.8	221.4	236.8	252.9
Overnight deposits	__	589.9	681.4	725.6	775.2
Overnight deposits - households	__	315.6	372.1	410.8	454.8
Overnight deposits - corporations	__	274.3	309.3	314.7	320.4
M2-M1 (quasi money)	1,012.4	864.1	863.3	881.8	892.1
Deposits with agreed maturity	__	651.2	666.4	675.4	679.7
Deposits with agreed maturity - households	__	448.6	439.8	458.6	451.7
Deposits with agreed maturity - corporations	__	202.5	226.6	216.7	228.0
Deposits redeemable at notice	__	194.3	185.6	198.8	198.8
Deposits redeemable at notice - households	__	190.7	182.3	194.6	194.7
Deposits redeemable at notice - corporation	__	3.6	3.2	4.2	4.1
Repurchase agreements	__	18.6	11.3	7.6	13.7
Annual percentage changes					
M1	17.3	35.0	14.6	6.6	6.4
M2	13.0	3.5	6.9	4.4	4.6
Loans to corporations and households	-19.6	-6.6	9.3	12.4	19.6
M2-M1 (deposits)	10.7	-14.6	-0.1	2.1	2.6
Annual percentage growth rates					
M1	__	__	15.5	8.3	7.2
M2	__	__	8.1	5.8	5.4
Loans to corporations and households	__	__	11.8	15.3	21.1
M2-M1 (deposits)	__	__	1.2	3.3	3.4

Table 7

INTEREST RATES ON INTERBANK DEPOSITS

percentages

	2001 12	2002 12	2003 12	2004 12	2005 9
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	1.76
- 14 day	4.78	2.76	2.03	2.51	1.76
- 1 month	4.77	2.73	2.04	2.53	1.77
- 2 month	4.72	2.67	2.06	2.55	1.78
- 3 month	4.69	2.63	2.08	2.57	1.80
- 6 month	4.62	2.60	2.13	2.67	1.82
- 9 month	4.61	2.60	2.22	2.76	1.85
- 12 month	4.62	2.60	2.30	2.85	1.88
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	1.66
- 14 day	4.69	2.67	1.93	2.41	1.66
- 1 month	4.68	2.64	1.94	2.43	1.67
- 2 month	4.62	2.57	1.96	2.45	1.68
- 3 month	4.59	2.54	1.98	2.47	1.70
- 6 month	4.52	2.51	2.03	2.57	1.72
- 9 month	4.52	2.51	2.12	2.66	1.75
- 12 month	4.52	2.51	2.20	2.75	1.78

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

Table 8

FRA RATES					percentages; monthly averages
	2001	2002	2003	2004	2005
	12	12	12	12	9
3 * 6	4.49	2.52	2.23	2.74	1.83
3 * 9	4.53	2.54	2.36	2.81	1.88
6 * 9	4.53	2.52	2.47	2.85	1.92
6 * 12	4.52	2.58	2.64	2.92	1.98
9 * 12	4.54	2.61	2.77	2.97	2.03
9*12 - 3*6 spread	0.05	0.10	0.55	0.24	0.20
6*12 - 3*9 spread	-0.02	0.04	0.28	0.12	0.10

IRS RATES					percentages; monthly averages
	2001	2002	2003	2004	2005
	12	12	12	12	9
1Y	4.64	2.63	2.41	2.82	1.92
2Y	4.72	2.85	2.98	3.06	2.15
3Y	4.89	3.18	3.38	3.27	2.36
4Y	5.05	3.46	3.69	3.45	2.55
5Y	5.19	3.70	3.93	3.62	2.70
6Y	5.32	3.91	4.13	3.77	2.84
7Y	5.43	4.08	4.29	3.89	2.96
8Y	5.52	4.23	4.43	4.00	3.06
9Y	5.60	4.36	4.54	4.09	3.16
10Y	5.66	4.47	4.64	4.17	3.25
15Y	5.85	4.77	4.97	4.40	3.53
20Y	—	—	5.11	4.54	3.68
5Y - 1Y spread	0.56	1.07	1.52	0.80	0.78
10Y - 1Y spread	1.02	1.84	2.23	1.35	1.33

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
	2W	1Y	new loans	time deposits	2W	1Y	new loans	time deposits	2W	1Y	client loans
1/01	5.3	5.6	6.3	3.9	1.0	1.3	2.0	-0.3	1.0	1.3	2.0
2/01	5.2	5.3	6.2	3.9	1.2	1.3	2.1	-0.1	0.5	0.6	1.4
3/01	5.0	5.1	6.2	3.7	0.9	0.9	2.0	-0.3	0.9	0.9	2.0
4/01	5.0	5.0	6.2	3.7	0.4	0.4	1.5	-0.9	1.0	0.9	2.1
5/01	5.0	5.0	6.3	3.7	0.0	0.0	1.2	-1.2	1.2	1.2	2.4
6/01	5.0	5.3	6.3	3.7	-0.4	-0.2	0.7	-1.7	1.6	1.8	2.8
7/01	5.1	5.6	6.4	3.7	-0.8	-0.2	0.5	-2.1	2.0	2.6	3.3
8/01	5.3	6.0	6.6	3.7	-0.2	0.5	1.0	-1.7	2.8	3.5	4.1
9/01	5.3	5.7	6.6	3.7	0.6	0.9	1.8	-0.9	3.4	3.8	4.7
10/01	5.3	5.3	6.6	3.7	0.9	0.9	2.1	-0.7	3.9	4.0	5.3
11/01	5.2	4.9	6.3	3.6	1.0	0.7	2.0	-0.5	4.3	4.0	5.4
12/01	4.8	4.6	5.9	3.3	0.7	0.5	1.7	-0.8	4.0	3.8	5.1
1/02	4.7	4.5	5.7	3.2	1.0	0.8	2.0	-0.4	4.1	3.9	5.1
2/02	4.3	4.4	5.1	3.0	0.4	0.5	1.1	-0.8	4.4	4.5	5.2
3/02	4.3	4.5	5.3	3.0	0.6	0.8	1.6	-0.7	4.5	4.7	5.5
4/02	4.2	4.4	5.1	2.9	1.0	1.1	1.8	-0.2	4.3	4.5	5.2
5/02	3.8	4.1	4.9	2.8	1.3	1.5	2.3	0.3	4.3	4.6	5.4
6/02	3.8	3.9	5.0	2.9	2.6	2.7	3.8	1.7	4.6	4.8	5.9
7/02	3.5	3.4	4.5	2.8	2.9	2.8	3.9	2.2	4.7	4.6	5.7
8/02	3.0	3.1	4.4	2.3	2.4	2.5	3.8	1.7	4.0	4.1	5.4
9/02	3.0	3.0	4.5	2.5	2.2	2.1	3.7	1.7	4.0	3.9	5.5
10/02	3.0	2.8	4.6	2.3	2.4	2.2	4.0	1.7	3.9	3.7	5.5
11/02	2.8	2.8	4.2	2.1	2.3	2.2	3.7	1.6	3.5	3.5	4.9
12/02	2.8	2.6	4.2	2.2	2.1	2.0	3.6	1.6	3.5	3.3	4.9
1/03	2.7	2.6	4.1	2.2	3.2	3.0	4.5	2.6	3.6	3.5	5.0
2/03	2.5	2.4	3.9	2.1	2.9	2.8	4.3	2.5	3.2	3.2	4.6
3/03	2.5	2.4	3.9	2.0	2.9	2.8	4.3	2.5	2.9	2.8	4.3
4/03	2.5	2.4	3.9	2.0	2.6	2.5	4.0	2.1	3.2	3.2	4.7
5/03	2.5	2.4	4.0	2.0	2.5	2.4	4.0	2.0	3.3	3.3	4.8
6/03	2.5	2.3	3.8	1.9	2.2	2.0	3.5	1.6	3.4	3.2	4.8
7/03	2.3	2.2	3.5	1.7	2.4	2.3	3.6	1.8	2.9	2.9	4.2
8/03	2.0	2.1	3.3	1.8	2.1	2.2	3.4	1.9	2.4	2.5	3.7
9/03	2.0	2.2	3.6	1.7	2.0	2.2	3.6	1.7	2.0	2.2	3.6
10/03	2.0	2.2	3.7	1.7	1.6	1.8	3.3	1.3	2.1	2.3	3.8
11/03	2.0	2.2	3.5	1.8	1.0	1.2	2.5	0.7	1.6	1.8	3.1
12/03	2.0	2.3	3.7	1.7	1.0	1.3	2.6	0.7	1.1	1.4	2.7
1/04	2.0	2.3	5.5	1.4	-0.3	0.0	3.1	-0.9	0.4	0.7	3.9
2/04	2.0	2.3	5.0	1.4	-0.3	0.0	2.7	-0.9	0.5	0.8	3.5
3/04	2.0	2.3	5.1	1.5	-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	5.7	1.4	0.5	0.5	4.3	0.1	-2.1	-2.1	1.6
6/05	1.8	1.8	5.3	1.4	0.0	0.0	3.4	-0.4	-0.9	-0.9	2.5
7/05	1.8	1.8	5.3	1.4	0.1	0.1	3.6	-0.3	-0.2	-0.2	3.3
8/05	1.8	1.9	5.3	1.4	0.1	0.2	3.5	-0.3	0.7	0.8	4.1
9/05	1.8	1.9	—	—	-0.4	-0.3	—	—	0.8	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	3.2	-0.9	—	—	—	—	—	—	—	—
6/05	-0.5	-0.5	2.9	-0.8	-0.9	-0.9	2.5	-1.2	-2.0	-2.0	1.4	-2.3
7/05	-0.6	-0.6	2.9	-0.9	—	—	—	—	—	—	—	—
8/05	-0.7	-0.6	2.7	-1.0	—	—	—	—	—	—	—	—
9/05	-0.7	-0.6	—	—	-1.0	-0.9	—	—	-3.3	-3.2	—	—

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 8
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	7.41
- maturity up to 1 year	8.20	10.35	11.21	12.81	13.37
- maturity over 1 year and up to 5 years	10.55	10.80	10.17	12.40	11.74
- maturity over 5 years	8.02	7.35	6.65	6.39	6.07
for consumption - total	__	13.83	13.83	14.89	14.17
- maturity up to 1 year	__	13.05	14.26	15.48	16.24
- maturity over 1 year and up to 5 years	__	14.48	13.86	15.17	15.13
- maturity over 5 years	__	12.55	13.21	13.45	11.82
for house purchase - total	__	7.11	6.31	5.93	5.48
- maturity up to 1 year	__	7.67	6.24	4.48	4.54
- maturity over 1 year and up to 5 years	__	7.90	7.05	6.57	6.33
- maturity over 5 years	__	6.88	6.09	5.89	5.44
other - total	__	6.99	7.80	7.50	7.13
- maturity up to 1 year	__	6.64	8.49	8.96	9.31
- maturity over 1 year and up to 5 years	__	6.34	8.02	7.63	6.93
- maturity over 5 years	__	7.61	7.02	6.58	6.02
Non-financial corporations (S.11) - total	6.84	5.19	4.53	4.75	4.03
- maturity up to 1 year	6.32	4.34	4.08	4.35	3.59
- maturity over 1 year and up to 5 years	6.93	5.47	4.64	4.68	4.00
- maturity over 5 years	7.52	6.34	5.14	5.39	4.67
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	1.18
overnight	1.42	0.94	0.50	0.52	0.38
with agreed maturity - total	3.11	2.26	2.02	2.13	1.87
- with agreed maturity up to 2 years	__	1.68	0.96	1.37	0.79
- with agreed maturity over 2 years	__	3.04	2.90	2.69	2.58
redeemable at notice - total	__	1.81	1.26	1.63	1.50
- redeemable at notice up to 3 months	__	1.93	1.67	2.14	2.10
- redeemable at notice over 3 months	__	1.73	0.98	1.12	0.77
Non-financial corporations (S.11) - total	1.96	1.25	0.85	1.21	0.88
overnight	1.00	0.94	0.64	0.68	0.53
with agreed maturity - total	3.62	2.16	1.50	2.08	1.41
- with agreed maturity up to 2 years	__	2.15	1.49	2.05	1.38
- with agreed maturity over 2 years	__	3.47	3.04	3.12	2.56
redeemable at notice - total	__	1.64	1.17	1.60	1.00
- redeemable at notice up to 3 months	__	1.60	1.14	1.49	0.92
- redeemable at notice over 3 months	__	2.26	1.32	2.26	1.55

Table 12

BALANCE OF PAYMENTS [1]					in CZK millions
	2001	2002	2003	2004 [2]	2005 [2]
	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q2
A. Current account	-124,478.3	-136,378.1	-160,614.6	-143,259.0	-30,772.4
Balance of trade [3]	-116,685.0	-71,323.0	-69,793.0	-22,325.0	15,195.0
exports	1,269,634.0	1,254,394.0	1,370,930.0	1,713,694.0	479,360.0
imports	1,386,319.0	1,325,717.0	1,440,723.0	1,736,019.0	464,165.0
Services	57,984.9	21,850.8	13,236.7	12,472.5	5,677.7
credit	269,689.6	231,131.1	219,151.1	248,433.1	66,844.7
transport	57,492.3	56,560.5	60,556.3	72,308.9	20,596.6
travel	118,133.0	96,289.2	100,310.1	107,129.8	27,263.0
others	94,064.3	78,281.4	58,284.7	68,994.4	18,985.1
debit	211,704.7	209,280.3	205,914.4	235,960.6	61,167.0
transport	30,570.5	29,332.8	33,725.7	38,603.0	10,188.8
travel	52,802.0	51,549.3	54,419.2	58,362.8	14,937.3
others	128,332.2	128,398.2	117,769.5	138,994.8	36,040.9
Income	-83,548.9	-115,615.0	-119,858.4	-139,535.9	-54,809.7
credit	84,892.3	66,790.1	75,508.3	70,209.1	23,551.3
debit	168,441.2	182,405.1	195,366.7	209,745.0	78,361.0
Current transfers	17,770.7	28,709.1	15,800.1	6,129.4	3,164.6
credit	36,404.9	46,709.0	46,976.7	46,045.3	14,460.4
debit	18,634.2	17,999.9	31,176.6	39,915.9	11,295.8
B. Capital account	-330.7	-119.4	-82.2	-14,017.0	1,316.5
credit	90.4	221.0	198.2	5,608.2	1,433.0
debit	421.1	340.4	280.4	19,625.2	116.5
Total A + B	*-124,809.0*	*-136,497.5*	*-160,696.8*	*-157,276.0*	*-29,455.9*
C. Financial account	172,849.9	347,827.4	157,093.5	180,923.0	101,550.8
Direct investment	208,296.1	270,930.2	53,500.3	100,673.6	135,510.1
abroad	-6,289.2	-6,759.3	-5,815.7	-14,038.9	-1,027.0
equity capital and reinvested earnings	-5,848.5	-5,376.8	-3,124.6	-12,732.3	-974.7
other capital	-440.7	-1,382.5	-2,691.1	-1,306.6	-52.3
in the Czech Republic	214,585.3	277,689.5	59,316.0	114,712.5	136,537.1
equity capital and reinvested earnings	185,981.4	270,061.0	59,350.4	104,432.3	125,950.7
other capital	28,603.9	7,628.5	-34.4	10,280.2	10,586.4
Portfolio investment	34,857.3	-46,748.7	-35,719.1	62,209.2	54.5
assets	4,405.6	-75,602.1	-83,892.7	-61,068.5	-15,860.0
equity securities	9,447.8	-7,807.9	5,630.5	-27,280.4	-1,441.6
debt securities	-5,042.2	-67,794.2	-89,523.2	-33,788.1	-14,418.4
liabilities	30,451.7	28,853.4	48,173.6	123,277.7	15,914.5
equity securities	23,203.6	-9,035.7	30,133.5	19,558.6	-1,711.5
debt securities	7,248.1	37,889.1	18,040.1	103,719.1	17,626.0
Financial derivatives	-3,220.3	-4,281.7	3,860.1	-1,539.7	-401.4
assets	-9,407.6	-15,458.4	7,083.7	-13,902.7	-9,834.3
liabilities	6,187.3	11,176.7	-3,223.6	12,363.0	9,432.9
Other investment	-67,083.2	127,927.6	135,452.2	19,579.9	-33,612.4
assets	-46,144.5	133,121.8	67,071.3	-35,983.8	-33,118.3
long-term	1,325.8	28,711.4	1,141.3	20,516.9	1,171.3
CNB	—	—	—	-184.9	-176.3
commercial banks	-4,125.8	5,271.7	-999.9	587.7	378.9
government	6,928.9	25,333.6	5,714.3	22,790.7	3,158.7
other sectors	-1,477.3	-1,893.9	-3,573.1	-2,676.6	-2,190.0
short-term	-47,470.3	104,410.4	65,930.0	-56,500.7	-34,289.6
commercial banks	-45,523.2	122,163.8	44,971.2	-34,807.6	-42,200.3
government	-87.1	-2,237.4	2,193.8	92.9	7.7
other sectors	-1,860.0	-15,516.0	18,765.0	-21,786.0	7,903.0
liabilities	-20,938.7	-5,194.2	68,380.9	55,563.7	-494.1
long-term	-4,262.6	2,853.8	26,361.6	29,813.4	13,698.1
CNB	-22.0	-20.2	-20.4	-20.5	—
commercial banks	-7,222.2	-8,059.2	-5,038.0	-1,410.8	190.7
government	-5,000.8	-1,517.2	10,304.7	9,264.7	10,725.3
other sectors	7,982.4	12,450.4	21,115.3	21,980.0	2,782.1
short-term	-16,676.1	-8,048.0	42,019.3	25,750.3	-14,192.2
CNB	59.7	-24.3	-21.4	843.7	598.2
commercial banks	-35,688.6	-3,871.2	37,899.4	-14,766.2	-16,643.8
government	—	—	—	—	—
other sectors	18,952.8	-4,152.5	4,141.3	39,672.8	1,853.4
Total A + B + C	*48,040.9*	*211,329.9*	*-3,603.3*	*23,647.0*	*72,094.9*
D. Net errors and omissions, valuation changes	19,112.1	5,615.1	16,506.7	-16,864.8	11,581.0
Total A + B + C + D	*67,153.0*	*216,945.0*	*12,903.4*	*6,782.2*	*83,675.9*
E. Change in reserves (- increase)	-67,153.0	-216,945.0	-12,903.4	-6,782.2	-83,675.9

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] 30 Jun.
Assets	1,544,963.0	1,579,922.9	1,537,284.6	1,535,040.8	1,767,317.8
Direct investment abroad	41,176.1	44,397.1	58,581.5	68,450.0	72,035.0
- equity capital	37,633.6	39,472.1	50,965.5	60,050.0	63,720.0
- other capital	3,542.5	4,925.0	7,616.0	8,400.0	8,315.0
Portfolio investment	185,138.6	274,344.7	343,968.7	369,425.6	413,041.7
- equity securities	68,675.5	86,464.7	47,337.7	73,309.3	82,771.2
- debt securities	116,463.1	187,880.0	296,631.0	296,116.3	330,270.5
Financial derivatives	15,754.8	31,213.2	24,129.5	38,032.2	50,709.4
Other investment	778,435.7	515,356.2	419,090.0	422,891.5	485,022.8
long-term	310,133.9	179,639.6	157,598.6	118,694.3	121,437.2
- CNB	307.3	280.9	468.4	600.0	791.1
- commercial banks	79,663.7	67,966.9	66,121.3	58,055.5	58,651.3
- government	210,694.9	97,156.8	79,483.9	48,918.8	47,964.8
- other sectors	19,468.0	14,235.0	11,525.0	11,120.0	14,030.0
short-term	468,301.8	335,716.6	261,491.4	304,197.2	363,585.6
- CNB	51.2	376.7	98.8	71.7	118.0
- commercial banks	359,638.5	213,815.4	161,150.2	185,146.0	241,365.8
of which: gold and foreign exchange	257,138.6	163,032.9	115,884.8	128,118.7	163,078.3
- government	87.1	2,324.5	102.4	9.5	1.8
- other sectors	108,525.0	119,200.0	100,140.0	118,970.0	122,100.0
CNB reserves	524,457.8	714,611.7	691,514.9	636,241.5	746,508.9
- gold	4,469.9	4,653.8	4,784.3	4,253.9	4,730.7
- SDR	31.0	137.1	238.7	118.0	213.4
- reserve position in the IMF	5,478.3	7,081.5	11,949.9	9,137.5	8,083.2
- foreign exchange	514,188.0	686,516.1	674,451.8	622,606.4	733,390.9
- other reserve assets	290.6	16,223.2	90.2	125.7	90.7
Liabilities	1,789,030.7	1,977,177.7	2,064,768.3	2,360,031.1	2,552,792.5
Direct investment in the Czech Republic	982,335.0	1,165,529.1	1,161,783.6	1,261,710.9	1,397,838.7
- equity capital	837,537.3	1,013,102.9	1,009,391.8	1,106,150.9	1,229,118.7
- other capital	144,797.7	152,426.2	152,391.8	155,560.0	168,720.0
Portfolio investment	180,346.2	201,120.0	223,620.4	381,019.4	430,020.5
- equity securities	128,740.1	128,097.7	140,788.6	208,872.1	207,126.6
- debt securities	51,606.1	73,022.3	82,831.8	172,147.3	222,893.9
Financial derivatives	11,495.2	22,671.9	19,448.3	31,811.3	43,554.2
Other investment	614,854.3	587,856.7	659,916.0	685,489.5	681,379.1
long-term	332,593.2	326,321.3	360,279.2	372,377.2	386,590.1
- CNB	133.4	114.5	96.1	70.2	59.3
- commercial banks	73,688.6	63,541.0	58,056.3	52,020.9	51,466.6
- government	9,476.2	9,475.8	22,456.0	32,065.4	42,784.2
- other sectors	249,295.0	253,190.0	279,670.8	288,220.7	292,280.0
short-term	282,261.1	261,535.4	299,636.8	313,112.3	294,789.0
- CNB	68.5	44.2	22.8	866.5	951.9
- commercial banks	190,487.6	176,196.2	208,534.0	185,565.8	151,087.1
- government	—	—	—	—	—
- other sectors	91,705.0	85,295.0	91,080.0	126,680.0	142,750.0
Net investment position	-244,067.7	-397,254.8	-527,483.7	-824,990.3	-785,474.7

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)] 30 Jun.
Debt in convertible currencies	811,258.1	813,305.2	895,139.6	1,013,196.8	1,072,993.0
of which:					
Long-term	465,687.8	498,833.8	535,995.9	631,667.2	705,393.8
by debtor					
- CNB	133.4	114.5	96.1	70.2	59.3
- commercial banks	88,401.4	80,063.7	73,276.4	64,346.6	65,633.3
- government	30,839.2	47,701.3	69,029.9	147,729.1	196,330.0
- other sectors	346,313.8	370,954.3	393,593.5	419,521.3	443,371.2
by creditor					
- foreign banks	229,305.5	230,589.8	251,535.3	263,931.4	264,731.6
- government institutions	2,373.6	1,747.2	—	—	3,733.0
- multilateral institutions	70,879.0	69,894.7	83,779.6	84,862.4	97,564.8
- suppliers and direct investors	105,944.3	118,829.4	109,287.9	108,720.0	116,540.0
- other investors	57,185.4	77,772.7	91,393.1	174,153.4	222,824.4
Short-term	345,570.3	314,471.4	359,143.7	381,529.6	367,599.2
by debtor					
- CNB	68.5	44.2	22.8	866.5	951.9
- commercial banks	192,438.4	177,474.4	210,017.0	189,036.5	153,544.4
- government	465.0	761.0	710.0	3,334.6	3,155.5
- other sectors	152,598.4	136,191.8	148,393.9	188,292.0	209,947.4
by creditor					
- foreign banks	192,126.4	168,200.7	218,436.1	208,032.3	175,134.8
- multilateral institutions	—	—	—	861.3	948.2
- suppliers and direct investors	116,278.4	112,256.8	105,563.9	130,000.0	143,880.0
- other investors	37,165.5	34,013.9	35,143.7	42,636.0	47,636.2
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	1,072,993.0
of which:					
- long-term	465,687.8	498,833.8	535,995.9	631,667.2	705,393.8
- short-term	345,570.3	314,471.4	359,143.7	381,529.6	367,599.2
Total long-term debt	465,687.8	498,833.8	535,995.9	631,667.2	705,393.8
of which:					
- IMF loans	—	—	—	—	—
- liabilities of government sector and guaranteed by government, and liabilities of entities with majority owned by state	203,102.3	207,325.2	222,120.9	275,002.1	321,195.8
- liabilities of entities with majority private capital	262,585.5	291,508.6	313,875.0	356,665.1	384,198.0

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 7 - 9
CZK exchange rate against selected currencies					
- annual/quarterly averages					
1 EUR	34.08	30.81	31.84	31.90	29.68
1 USD	38.04	32.74	28.23	25.70	24.31
100 SKK	78.68	72.22	76.75	79.69	76.69
	12	**12**	**12**	**12**	**9**
- monthly averages					
1 EUR	32.59	31.19	32.31	30.65	29.31
1 USD	36.48	30.65	26.32	22.87	23.90
100 SKK	75.61	74.67	78.57	78.81	76.23
	31 Dec.	**31 Dec.**	**31 Dec.**	**31 Dec.**	**30 Sep.**
- last day of the month					
1 EUR	31.98	31.60	32.41	30.47	29.55
1 USD	36.26	30.14	25.65	22.37	24.54
100 SKK	74.81	75.18	78.71	78.63	76.18

B. NOMINAL EFFECTIVE RATE	2001	2002	2003	2004	2005 9
CZK nominal effective exchange rate (percentages)					
(2000=100)					
weights - foreign trade turnover	104.3	116.5	116.0	116.3	125.1
weights - foreign trade turnover SITC 5-8	104.4	116.1	115.6	115.5	124.4

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 8
CZK real effective exchange rate (percentages)					
(2000=100)					
a) industrial producer prices					
weights - foreign trade turnover	104.3	115.2	111.3	114.0	118.6
weights - foreign trade turnover SITC 5-8	104.9	115.9	112.0	115.4	120.9
b) consumer prices					
weights - foreign trade turnover	105.5	116.7	112.9	113.0	119.8
weights - foreign trade turnover SITC 5-8	106.2	117.5	113.7	114.1	121.6

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

Table 16

PUBLIC FINANCES					in CZK billions
	2001 1 - 12	2002 1 - 12	2003 1 - 12	2004 1 - 12	2005 1 - 9
STATE BUDGET					
Total revenue	626.2	705.0	699.7	769.2	634.1
Tax revenue	598.3	627.4	667.5	716.7	568.6
Taxes on income, profits and capital gains	147.4	159.0	172.9	180.7	147.2
Domestic taxes on goods and services	187.0	186.9	198.4	223.2	183.6
- value-added taxes	121.3	118.1	125.6	140.4	101.4
- excises	65.7	68.9	72.9	82.8	82.2
Taxes on property	6.4	7.9	8.8	10.4	6.0
Social and health security contributions and payroll taxes	242.3	258.5	272.4	293.3	227.7
Non-tax and capital incomes and received subsidies	27.9	77.7	32.2	52.5	65.5
Total expenditure	693.9	750.8	808.7	862.9	608.3
Current expenditure	642.5	697.3	745.4	796.8	572.9
Capital expenditure	51.4	53.5	63.3	66.1	35.5
Public budgets (balance in IMF GFS methodology) [1]	-48.8	-11.5	-129.4	-90.4	__
state budget	-63.3	-45.7	-106.6	-65.0	25.7
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 9
BCPP					
PX 50	394.6	460.7	659.1	1,032.0	1,453.7
PX-D	1,065.6	1,166.4	1,642.7	2,551.1	3,666.0
PX-GLOB	492.9	576.8	816.9	1,232.7	1,771.7
RM-SYSTÉM					
PK-30	593.0	672.5	947.5	1,443.5	2,361.0

in CZK millions

B. TRADE VOLUMES	2001 12	2002 12	2003 12	2004 12	2005 9
BCPP					
Monthly trade volumes	142,803.6	109,264.8	98,640.0	90,610.5	164,477.5
of which:					
a) shares	12,819.3	17,089.3	28,296.0	46,210.3	129,257.0
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	35,220.4
RM-SYSTÉM					
Monthly trade volumes	2,162.5	4,412.1	1,103.0	335.8	564.0
of which:					
a) shares	1,841.0	298.4	1,082.5	332.7	560.9
b) units	212.2	1.0	3.7	3.1	3.0
c) bonds	109.3	4,112.7	16.8	0.0	0.1

Table 18

CNB MONETARY POLICY INSTRUMENTS

	2W repo rate (%)	Discount rate (%)	Lombard rate (%)	Minimum reserve requirement for primary deposits (%)	
				Banks	Building societies and ČMZRB
1999					
18 January	8.75	—	—	—	—
28 January	—	—	—	5.0	—
29 January	8.00	—	—	—	—
12 March	7.50	6.0	10.0	—	—
9 April	7.20	—	—	—	—
4 May	6.90	—	—	—	—
25 June	6.50	—	—	—	—
30 July	6.25	—	—	—	—
3 September	6.00	5.5	8.0	—	—
5 October	5.75	—	—	—	—
7 October	—	—	—	2.0	2.0
27 October	5.50	5.0	7.5	—	—
26 November	5.25	—	—	—	—
2000	No changes made				
2001					
23 February	5.00	4.0	6.0	—	—
27 July	5.25	4.25	6.25	—	—
30 November	4.75	3.75	5.75	—	—
2002					
22 January	4.50	3.50	5.50	—	—
1 February	4.25	3.25	5.25	—	—
26 April	3.75	2.75	4.75	—	—
26 July	3.00	2.00	4.00	—	—
1 November	2.75	1.75	3.75	—	—
2003					
31 January	2.50	1.50	3.50	—	—
26 June	2.25	1.25	3.25	—	—
1 August	2.00	1.00	3.00	—	—
2004					
25 June	2.25	1.25	3.25	—	—
27 August	2.50	1.50	3.50	—	—
2005					
28 January	2.25	1.25	3.25	—	—
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 Q2
Gross domestic product					
- in CZK millions	1,617,894	1,641,996	1,694,684	1,769,936	476,421
- percentages	2.6	1.5	3.2	4.4	5.1
Final consumption					
- in CZK millions	1,215,582	1,255,918	1,310,914	1,321,457	334,913
- percentages	3.0	3.3	4.4	0.8	1.8
of which:					
Households					
- in CZK millions	851,305	874,649	915,270	933,555	236,493
- percentages	2.8	2.7	4.6	2.0	2.1
Government					
- in CZK millions	355,593	371,673	385,895	378,082	95,819
- percentages	3.8	4.5	3.8	-2.0	0.9
Non-profit institutions					
- in CZK millions	8,793	9,506	9,807	10,948	2,885
- percentages	-12.3	8.1	3.2	11.6	8.9
Gross capital formation					
- in CZK millions	534,349	552,819	559,901	603,382	160,499
- percentages	6.3	3.5	1.3	7.8	-4.1
of which:					
Fixed capital					
- in CZK millions	507,629	524,964	549,815	591,362	155,043
- percentages	5.4	3.4	4.7	7.6	2.3
Changes in inventories					
- in CZK millions	26,627	27,731	9,931	11,861	5,403
Acquisitions less disposals of valuables					
- in CZK millions	93	124	155	159	53
- percentages	-43.8	33.0	25.7	2.6	43.1
Foreign trade					
of which:					
Exports of goods					
- in CZK millions	1,109,034	1,175,324	1,294,538	1,598,967	456,466
- percentages	14.4	6.0	10.1	23.5	7.6
Exports of services					
- in CZK millions	192,798	162,181	151,004	168,545	44,671
- percentages	-1.2	-15.9	-6.9	11.6	2.4
Imports of goods					
- in CZK millions	1,244,593	1,302,315	1,418,198	1,682,912	453,076
- percentages	14.7	4.6	8.9	19.4	-0.1
Imports of services					
- in CZK millions	201,328	214,620	217,569	243,488	61,271
- percentages	3.3	6.6	1.4	11.9	1.9
Final domestic demand					
- in CZK millions	1,723,211	1,780,882	1,860,729	1,912,819	489,956
- percentages	3.7	3.3	4.5	2.8	2.0
Aggregate domestic demand					
- in CZK millions	1,749,931	1,808,737	1,870,815	1,924,839	495,412
- percentages	4.0	3.4	3.4	2.9	-0.2
Gross domestic product at current prices					
- in CZK millions	2,315,255	2,414,669	2,555,783	2,750,256	743,490
- percentages	7.7	4.3	5.8	7.6	5.3

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 Q2
Current income	5.7	6.4	5.9	4.7	4.1
of which:					
- gross operating surplus and mixed income	8.3	2.4	7.7	4.9	3.2
- compensation of employees	6.8	8.5	5.5	5.4	5.8
- property income	0.8	-0.9	5.3	8.0	-6.4
- social benefits other than social transfers in kind	4.6	8.0	3.6	3.8	-0.1
- other current transfers	-9.0	4.1	10.9	-4.5	14.7
Current expenditure	6.6	8.4	9.5	5.9	7.6
of which:					
- property income	1.7	15.1	21.3	11.7	13.4
- current taxes on income, wealth, etc.	5.9	8.2	12.1	5.1	9.6
- social contributions	6.8	8.9	7.2	7.7	7.1
- other current transfers	8.5	4.7	12.5	-2.8	4.9
Gross disposable income	5.3	5.6	4.3	4.2	2.3
Change in net equity of households in pension funds reserves	23.9	22.6	15.4	16.2	-26.5
Individual consumption expenditure	6.4	3.5	6.5	4.8	3.3
Gross saving	-4.7	31.8	-15.5	-1.4	-12.5
Gross saving rate	7.93	9.90	8.03	7.60	7.29
(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 Q2
Whole-economy nominal wage	8.1	7.0	6.4	6.2	5.4
Business sector	7.7	6.3	5.5	6.3	5.4
Non-business sector	9.6	9.8	9.8	5.7	5.4
Whole-economy real wage	3.2	5.1	6.3	3.3	3.7
Business sector	2.9	4.4	5.4	3.4	3.7
Non-business sector	4.7	7.9	9.7	2.8	3.7

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 9
Registered job applicants (thousands)	461.9	514.4	542.4	541.7	503.4
Unemployment rate (percentages)	8.9	9.8	10.3	10.3	__
Unemployment rate (percentages) [1]	__	__	__	9.5	8.8

1) Unemployment rate calculated according to the new methodology from 1 July 2004

Source: CZSO

Table 21

PRODUCER PRICES percentage changes

	2001	2002	2003	2004	2005 9
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	1.0
c) average for 2000 = 100	2.8	2.3	1.9	7.7	10.8
d) December 1999 = 100	6.3	5.8	5.4	11.4	14.6
Construction work prices					
a) previous month = 100	0.3	0.2	0.2	0.4	0.3
b) same period of last year = 100	4.1	2.7	2.2	3.7	2.5
c) average for 2000 = 100	4.1	6.9	9.2	13.3	17.1
d) December 1999 = 100	6.5	9.3	11.7	15.8	19.8
Agricultural producer prices					
b) same period of last year = 100	8.4	-9.5	-2.9	8.1	-6.7
of which:					
crop products					
b) same period of last year = 100	9.3	-4.6	-1.0	11.6	-15.6
livestock products					
b) same period of last year = 100	8.0	-12.1	-4.0	6.1	-2.2
Market services prices					
a) previous month = 100	0.1	0.3	0.0	0.2	0.8
b) same period of last year = 100	3.9	3.2	1.6	2.3	2.8
c) average for 2000 = 100	4.0	7.3	9.0	11.5	14.8
d) December 1999 = 100	4.6	8.0	9.7	12.2	15.5

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

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