INFLATION REPORT / APRIL

2006

CNB CZECH NATIONAL BANK

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ABBREVIATIONS USED

ARA	Amsterdam-Rotterdam-Antwerp
BCPP	Prague Stock Exchange
CHF	Swiss franc
ČEZ	České energetické závody, a power utility company
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	pound sterling
GDP	gross domestic product
HICP	Harmonised Index of Consumer Prices
IMF	International Monetary Fund
IRS	interest rate swap
JPY	Japanese yen
LFS	Labour Force Survey
LIBOR	London Interbank Offered Rate
M1, M2	monetary aggregates
MFIs	monetary financial institutions
MLSA	Ministry of Labour and Social Affairs
NBS	National Bank of Slovakia
NCG	net credit to government
NEAs	net external assets
OMFIs	other monetary financial institutions
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 4 May 2006.

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 was just below the point inflation target in 2006 Q1
(annual percentage changes in CPI)

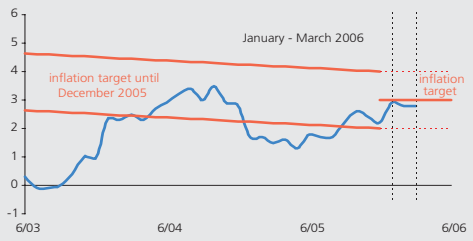


Table I.1
The Czech economy grew at its fastest ever rate in 2005 Q4
(annual percentage changes unless otherwise indicated)

	12/05	01/06	02/06	03/06
Consumer price inflation	2.2	2.9	2.8	2.8
Industrial producer price inflation	-0.3	0.3	0.3	0.3
Money supply growth (M2)	8.0	8.9	7.9	-
3M PRIBOR[a] (in per cent)	2.2	2.1	2.0	2.1
Nominal CZK/EUR exchange rate[a] (level)	28.98	28.72	28.41	28.65
State budget balance since January incl. SFAOs[b] (CZK bn)	-56.4	3.4	-0.6	15.7
GDP growth at constant prices[c]	6.9			-
Unemployment rate[b] (in per cent)	8.9	9.2	9.1	8.8

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

Inflation rose in 2006 Q1, fluctuating just below the point inflation target (see Chart I.1). The Czech economy grew at a record high rate in 2005 Q4. The favourable economic growth had yet to pass through into a significant decline in unemployment or faster wage growth and hence was not generating demand-pull inflationary pressures. Market interest rates fell in the first two months of 2006, but increased in March. The koruna's exchange rate against both major currencies was stronger than in the previous quarter.

Annual consumer price inflation rose to 2.9% in January 2006, up by 0.7 percentage point on the previous month. In the remaining months of Q1, inflation declined only slightly. The higher inflation in Q1 was due mainly to regulated prices and, within this category, especially to prices of electricity, heat and natural gas for households. Year-on-year growth in fuel prices also increased slightly, following oil price growth on world markets at the end of 2005 and the start of 2006.

GDP grew by almost 7% in 2005 Q4 and was more than one percentage point higher than in the previous quarter. The Czech economy also grew at a record high rate of 6% during 2005 as a whole (following an upward revision for the first three quarters). The external sector accounted for most of the economic growth in 2005 as a whole, including Q4. Despite sluggish growth in external demand and appreciation of the real exchange rate of the koruna, growth in exports of goods and services maintained a clear lead over import growth. The contribution of the other components of GDP to the economic growth was much smaller.

Although the buoyant growth of the Czech economy created the right conditions for rising employment, year-on-year employment growth slowed slightly in 2005 Q4 compared to the previous quarter. The cyclical component of registered unemployment did not decline to the extent corresponding to the changes in employment. One of the reasons was an increasing number of foreign employees. In this situation, corporations' growing demand for labour did not lead to higher nominal wage growth in the business sector. On the contrary, the year-on-year growth in Q4 slowed to its lowest value in two years. Nominal wages in the non-business sector also rose more slowly, although unlike wages in the business sector their annual growth was faster than in 2004.

The money market saw a decline in interest rates in the first two months of 2006, caused by market expectations that the CNB would lower its monetary policy rates. However, the Bank Board's decision at the end of February to leave these rates unchanged and the increase in the ECB's key rates at the beginning of March led to an upswing in money market interest rates. At the end of March, interest rates at shorter maturities were broadly at their end-December 2005 levels and rates at longer maturities were only slightly lower.

The koruna's exchange rate against both major currencies appreciated in January. The koruna continued to appreciate against the euro in February, but depreciated slightly against the dollar. In March it then depreciated against both currencies, but remained stronger than in the previous quarter. The koruna's exchange rate was affected primarily by the favourable macroeconomic developments, investors' positive sentiment about the Central European region, the actual and expected changes in interest rates in the Czech Republic and the euro area and by the euro-dollar exchange rate.

The monetary policy decision-making of the CNB Bank Board in 2006 Q1 was based on the inflation forecast discussed by the Board at its meeting on 26 January 2006 and published in the January Inflation Report. Given the monetary policy transmission lag, the Board focused on hitting the inflation target at roughly the 12–18 month horizon, i.e. in the first half of 2007. According to the forecast,

inflation should be close to the CNB's point inflation target in this period. Consistent with the baseline scenario was a gradual rise in interest rates, albeit to a lesser extent than assumed in the October forecast.

The Bank Board made no changes to monetary policy interest rates during 2006 Q1. Although the January forecast for this period indicated a slight rise in interest rates, the Bank Board assessed the risks to inflation as being generally on the downside, particularly at its January and February monetary meetings. On the basis of this assessment, two members of the Bank Board voted in January for a modest reduction of the CNB's key interest rates. In February, one board member was in favour of a reduction. In March, the risks of the forecast were assessed as being more balanced and the voting was thus unanimous in favour of keeping interest rates unchanged. The Bank Board identified the current evolution of the koruna exchange rate and that expected by the markets going forward, which remains stronger than forecasted, as being the main downside risks to inflation.

Section IV of this Inflation Report describes the CNB's new forecast. In the light of the new data on economic activity, the April forecast partially changes the view regarding the recent evolution of the output gap and estimates that it closed at the end of 2005 and the start of 2006. However, the output gap will not open significantly into positive figures, owing to a tighter exchange rate component of the monetary conditions and weak external demand. In the coming years, the output gap will thus remain close to zero, and its effect on inflation is broadly neutral over the entire forecast horizon. Owing to the anti-inflationary effect of the nominal exchange rate and the related downscaling of the import price and food price forecasts, the inflation forecast for 2006 and 2007 has decreased slightly. At the monetary policy horizon, inflation initially lies very close to the point inflation target but then increases above it. The pick-up in inflation during 2007 will result mainly from a higher contribution of changes to indirect taxes and increasing inflation expectations in response to the current cost pressures.

The mechanism of caveats will as usual apply to the first-round effects of indirect taxes, whose impact will be particularly pronounced in 2007. Adjusted for these effects, inflation to which monetary policy reacts remains slightly below the point inflation target at the monetary policy horizon. Consistent with the macroeconomic forecast and its assumptions is interest rate stability initially and a gradual rise in rates thereafter.

Chart I.2
The inflation forecast is above the point inflation target in the second half of the monetary policy horizon
(annual percentage changes in CPI)

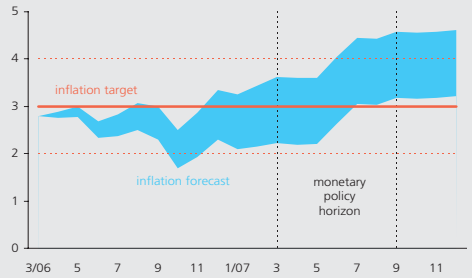
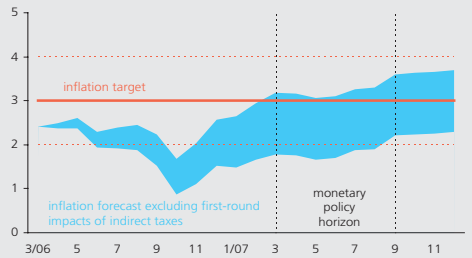


Chart I.3
Excluding the first-round impacts of indirect taxes, inflation is below the point inflation target at the monetary policy horizon
(annual percentage changes)



II.1 PAST INFLATION DEVELOPMENTS

Annual inflation[1] increased to 2.8% in 2006 Q1. Compared to December it was 0.6 percentage point higher. Annual consumer price inflation rose to 2.9% in January and stabilised at 2.8% in the following two months. The inflation rate[2] rose in Q1 to stand at 2.2% in March.

The pick-up in annual consumer price inflation at the beginning of 2006 was mainly due to rising prices of energy for households. Their impact was greatest in the category of housing, water, energy and fuels, where prices in March surged by 1.9 percentage points year on year compared to December 2005, to 7%. The upswing in inflation in this category was mostly attributable to higher electricity prices, followed by increased prices of natural gas and heat energy. Inflation in the transport category also rose (to 4.2% in March) owing to oil price developments on world markets. These two categories accounted for roughly 80% of the annual consumer price inflation of 2.8% in March. Prices in postal services and telecommunication, which continued to display the fastest growth in the consumer basket, also contributed significantly. Overall, these price movements generated a more marked pick-up in regulated price inflation. Market prices rose only modestly, primarily due to the higher prices of fuels.

Domestic prices thus continued to be affected by the fast growing prices of imported energy-producing materials – oil and natural gas – in 2006 Q1. Growth in world oil prices picked up again at the end of 2005 and the start of 2006 and subsequently fostered a slight upturn in industrial producer price inflation. However, it had a major effect only on producer prices at the initial stages of the product vertical. Import prices of natural gas and domestic electricity prices also displayed fast growth at the beginning of 2006. Conversely, falling prices of most other imported inputs continued to foster slower growth in domestic prices. The favourable trend in the personnel cost-output ratio also continued, with most of the monitored sectors contributing to the overall decline in nominal unit wage costs.

By the CNB's estimation, the economy reached its potential, non-accelerating inflation level of output at the end of 2005 and the start of 2006. There were consequently no demand pressures visible in the economy. Wage growth was subdued and consumer demand growth was low. Competition on the retail market remained strong. Inflation was also counteracted by the mostly falling prices of imports of final products. Under these circumstances, in the first three months of 2006 the fast growing prices of both imported and domestic energy sources (electricity) continued to pass through significantly only into consumer prices of fuels and housing.

The aforementioned demand and supply-side factors helped to keep growth in market prices in check. Their annual growth increased only slightly in 2006 Q1, from 0.4% in December 2005 to 0.6% in March. The contribution of market prices to the total annual growth in consumer prices was insignificant; regulated prices have been the major component of inflation for several quarters now (see Chart II.2).[3] Food prices and prices of non-food commodities both contributed to the slight overall growth in market prices at the start of 2006. In the case of food prices, inflation was lower than expected.

Chart II.1
Inflation increased in 2006 Q1
(percentages)

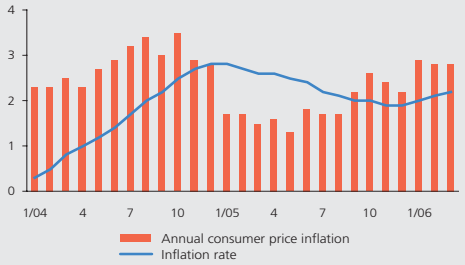
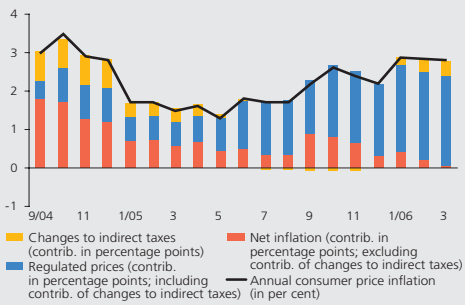


Table II.1
Prices in housing and transport were the biggest contributors to the upswing in consumer price inflation
(annual percentage changes)

	9/05	10/05	11/05	12/05	1/06	2/06	3/06
Consumer prices	2.2	2.6	2.4	2.2	2.9	2.8	2.8
Food and non-alcoholic beverages	-0.3	0.3	0.4	-0.9	-0.5	-0.7	-0.7
Alcoholic beverages and tobacco	0.0	0.2	0.2	0.7	0.8	0.8	0.9
Clothing and footwear	-5.7	-6.2	-6.3	-6.6	-5.9	-5.9	-5.9
Housing, water, electricity, gas and other fuels	4.1	5.1	5.1	5.1	7.0	7.0	7.0
Furnishings, household equipment and routine maintenance of the house	-2.0	-1.9	-1.8	-1.8	-1.7	-1.5	-1.6
Health	7.6	7.4	7.4	7.4	4.3	4.1	4.4
Transport	6.8	5.6	4.2	3.6	4.4	4.8	4.2
Communication	15.6	14.0	14.0	14.1	14.7	13.2	13.2
Recreation and culture	1.1	2.6	2.4	2.4	2.0	1.7	1.8
Education	1.4	1.8	1.8	1.8	4.5	4.0	3.7
Hotels and restaurants	3.0	2.9	2.8	2.7	2.7	2.5	2.4
Miscellaneous goods and services	0.4	0.6	0.5	0.5	1.3	1.3	1.5

Chart II.2
Regulated prices accounted for most of the inflation recorded in 2006 Q1; the contribution of market prices was small
(percentages; percentage points)



[1] Measured by annual growth in consumer prices.

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

[3] The assessment in the text relates to market prices including tax changes. In Chart II.2, market prices are measured by net inflation excluding tax changes.

Food prices fell slightly year on year during 2006 Q1 (by 0.3% in March).[4] As in previous quarters, food prices were affected by falling agricultural producer prices and food import prices and also by tough competition on the domestic market. Agricultural producer prices, however, were by now falling noticeably more slowly than in previous quarters and recorded slight year-on-year growth in March. Import prices have also been exerting a weaker anti-inflationary effect since the end of last year. These changes, however, were not yet reflected in food prices at the beginning of 2006. Most food price items were still falling slightly in year-on-year comparison, with prices of only two products (vegetables and potatoes) picking up considerably. The increase in excise duties on cigarettes and tobacco products[5] also passed through to food prices with a significant lag, due to stocks being sold off at their original price. Overall, however, cigarette prices increased by much less than would correspond to the increase in excise duties.

Annual growth in prices of non-food commodities[6] remained moderate in 2006 Q1 (1% in March). They continued to show mixed structural trends, owing to the considerable diversity of the key factors affecting prices in the main components of this price index. As in previous quarters, the fastest growth was displayed by fuel prices, which tend to fluctuate in line with oil prices on world markets. The year-on-year pick-up in fuel price growth in 2006 Q1 to values exceeding 10% reflected the relatively fast response of producers and retailers to the increase in oil prices on world markets at the end of 2005 and the start of 2006.

The year-on-year decline in prices of other tradable commodities except fuels, which were significantly affected by the competitive external environment, continued into 2006 Q1. Nevertheless, compared to the end of the previous quarter it further moderated to 2.1%. The main factor underlying the long-term decline in prices of these commodities was the still relatively strong year-on-year appreciation of the koruna-euro exchange rate combined with the relatively low prices of many consumer products on foreign markets, which resulted in generally falling prices of imports of consumer goods. Other factors included low growth in consumer demand and tough price competition on the domestic market. Declining prices continued to be recorded in the categories of clothing and footwear and household equipment and furnishings in particular. Prices also fell in the categories of leisure and other goods in Q1.

Prices of nontradable market commodities, which consist primarily of domestic services, continued increasing year on year in 2006 Q1 (by 2.4% in March). The previous gradual slowdown in the growth rate was replaced at the beginning of the year by a modest pick-up[7], associated with rising unregulated prices in housing, health care and some other services. Even after this slight pick-up, the growth in prices of nontradable commodities was still subdued, in line with wages and the level of consumer demand.

Regulated prices again rose fairly fast in 2006 Q1. The further increase in their annual growth – of 2.2 percentage points to 11.2% compared to the end of the previous quarter – was mainly the result of a rise in prices of electricity, heat energy and natural gas for households with effect from 1 January 2006.[8] Further changes

Chart II.3
Food prices fell year on year in 2006 Q1
(annual percentage changes)

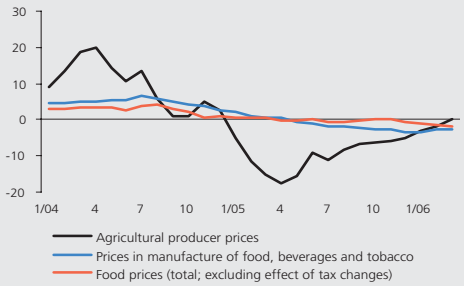


Chart II.4
Prices of fuels were the fastest growing among the non-food commodities
(annual percentage changes, including changes to indirect taxes)

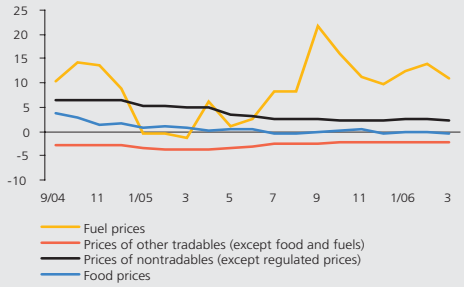
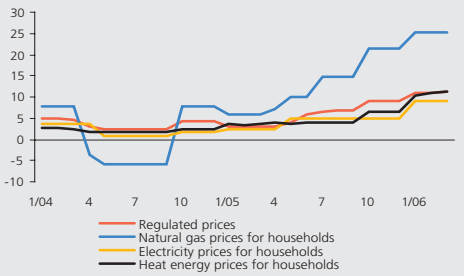


Chart II.5
The faster growth in regulated prices was due primarily to rising prices of energy sources for households
(annual percentage changes)



4 Consolidated category of food, non-alcoholic beverages, alcoholic beverages and tobacco. Includes changes to excise duties. Adjusted for changes to excise duties, their annual decline increased in 2006 Q1, reaching 1.8% in March.

5 With effect from 1 July 2005.

6 Consolidated category of prices of non-food commodities, comprising tradable commodities, non-tradable commodities and fuels.

7 Their year-on-year growth picked up from 2.2% in December to 2.6% in January, 2.5% in February and 2.4% in March.

8 With effect from 1 January 2006, prices of electricity for households were increased by 9%, heat supply prices by 6.3% and natural gas prices by 4.8% on average.

Chart II.6
Inflation in the Czech Republic was slightly higher than in the EU countries in 2006 Q1
(annual percentage changes)

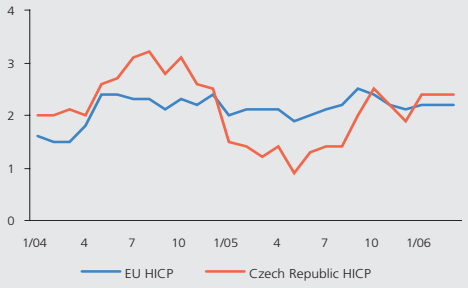


Table II.2
Headline inflation in 2006 Q1 was close to the October 2004 forecast
(annual percentage changes; contributions in percentage points)

	October 2004 forecast	2006 Q1 outturn	Contribution to total difference in perc. points [a)]
Annual consumer price inflation	3.0	2.8	-0.2
Breakdown into contributions:			
regulated prices	2.4	11.1	1.8
indirect taxes	0.6	0.3	-0.3
food prices, excluding effects of indirect taxes	0.9	-1.5	-0.6
fuel prices, excluding effects of indirect taxes	0.8	12.5	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.7
Actual inflation was lower than forecasted over the entire forecast horizon
(annual percentage changes)

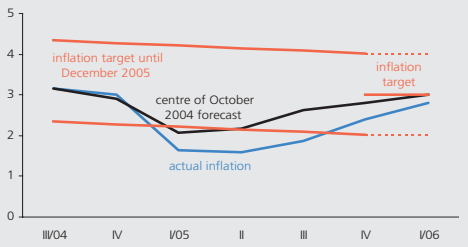


Table II.3
Lower external demand growth acted towards lower inflation

		IV/04	I/05	II/05	III/05	IV/05	I/06
GDP Germany[a)]	prediction	2.0	1.4	1.6	1.7	1.7	1.6
(annual perc. changes)	outturn	1.3	0.3	0.9	1.4	1.0	-
CPI in Germany	prediction	1.6	1.5	1.2	1.3	1.6	1.5
(annual perc. changes)	outturn	1.9	1.7	1.7	2.1	2.3	2.0
1Y EURIBOR	prediction	2.4	2.5	2.6	2.8	2.9	3.0
(percentages)	outturn	2.3	2.3	2.2	2.2	2.6	3.0
USD/EUR exchange rate	prediction	1.23	1.23	1.23	1.24	1.23	1.22
(levels)	outturn	1.30	1.31	1.26	1.22	1.19	1.20
Oil prices[b)]	prediction	34.8	33.2	31.9	31.3	31.3	31.3
(USD/barrel)	outturn	37.3	42.8	47.6	57.3	53.3	57.8

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

to prices of regulated items made as part of the usual repricing in Q1 did not affect regulated prices significantly.

Turning to international comparisons, annual consumer price inflation in the Czech Republic as measured by the harmonised index of consumer prices (HICP) was below the inflation level in the EU countries for most of 2005. In 2006 Q1, it slightly exceeded the figures recorded in the EU countries. On average, inflation in the Czech Republic was 0.2 percentage point higher; this can be attributed to the major changes made to prices of regulated items at the beginning of 2006. In March, the annual HICP was 2.4% in the Czech Republic and 2.2% in the EU countries (according to Eurostat's flash estimate).

II.2 FULFILMENT OF THE INFLATION TARGET

Headline inflation was close to the CNB's point inflation target in 2006 Q1 (see Chart I.1). This section of the Inflation Report briefly analyses the contribution of the CNB's monetary policy to this situation.

Changes to interest rates pass through into inflation most strongly with a lag of around 12 to 18 months. Accordingly, to assess the effect of monetary policy on the fulfilment of the inflation target in 2006 Q1, one needs to analyse retrospectively the forecasts, and the Bank Board's decisions based thereon, dating from around July 2004 to March 2005. For comprehensibility, the analysis of the accuracy of the forecasts is limited here to a comparison of the forecast drawn up in October 2004, i.e. approximately in the middle of the aforementioned period, with inflation in 2006 Q1 (see Table II.2).

The October 2004 forecast had predicted easy monetary policy in both the interest rate and exchange rate components of the monetary conditions. This prediction, together with an expected modest recovery in external economic activity, was to have led to a pick-up in domestic economic growth and to closure of the output gap in the first half of 2005. Changes to indirect taxes and regulated prices were also expected to join the inflationary effect of the closing output gap. Flat prices of food as a result of the above-average harvest in 2004 were predicted to act in the opposite direction, i.e. towards lower inflation. Overall, the October forecast predicted a slight decline in inflation to the lower boundary of the target band, followed by a renewed increase in inflation close to the point inflation target in 2006 Q1. Actual inflation was lower than forecasted over the entire forecast horizon (see Chart II.7). A closer look at the inflation structure reveals that the deviation in 2006 Q1 was due mainly to lower-than-forecasted growth in adjusted inflation excluding fuels, lower growth in food prices and smaller changes to indirect taxes. By contrast, growth in regulated prices and fuel prices acted towards higher inflation.

The difference in the actual inflation structure from the October forecast can be put down mainly to factors lying partly or completely outside the purview of the CNB's monetary policy. In addition to the different evolution of regulated prices and changes to indirect taxes, these factors included a continuing decline in food prices as a result of the above-average harvest in 2005, the disinflationary effect of lower external demand and an unexpected surge in oil prices on world markets (see Table II.3).

Consistent with the October forecast was a slight rise in interest rates. The actual interest rate path was roughly at the forecast level in 2004 Q4, but was well below the forecast in 2005. Interest rates were lowered three times by a total of 0.75 percentage point during 2005 H1 and then raised by 0.25 percentage point in October 2005. In the key period as regards the most recent consumer price developments, i.e. in 2004 H2 and 2005 Q1, nominal interest rates were slightly lower than forecasted. Nevertheless, interest rates in real terms were tighter than

forecasted, owing to a shift in the perception of real equilibrium interest rates. The nominal koruna-euro exchange rate was stronger than forecasted. However, given the current view of the rate of equilibrium appreciation, the effect of the real exchange rate is assessed as easier. Overall, then, the monetary policy effect was broadly in line with the assumptions of the October forecast.

Another 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. The only significant change made to the forecasting system since October 2004 was a revision to the evolution of the equilibrium variables. The estimate of the rate of real equilibrium appreciation was revised upwards and that of the real equilibrium rate was revised downwards. This adjustment generates an easier exchange rate component and a tighter interest rate component of the monetary conditions, although it does not significantly change the view of the monetary conditions as a whole.

When assessing the fulfilment of the October forecast, one should also take into account the revisions to the available economic indicators – particularly GDP – released since the forecast was drawn up. Several revisions have been made to the national accounts since October 2004. These revisions, especially that in March 2006, have markedly increased the estimate of GDP growth in 2004 and 2005. In the absence of any observable inflationary pressures, the revision of the national accounts has generated an increase of more than one percentage point in the estimated growth of the potential, non-accelerating inflation level of output. The initial output gap at the end of 2004 and the start of 2005 has meanwhile been revised towards a more anti-inflationary effect.

Based on the CNB's current knowledge of the workings of the Czech economy and its current knowledge of actual economic developments, the developments since the October forecast was drawn up can be briefly interpreted in the following way.

Despite a wider initial output gap, the gap closed rapidly during 2005. Underlying this was easy monetary policy, amid restrictive fiscal policy and weak external demand. The wider output gap manifested itself during 2005 in lower growth in adjusted inflation excluding fuels. The deviation of adjusted inflation from the assumptions of the October forecast can also be partly explained by faster-than-expected appreciation of the koruna's exchange rate, bolstered by lower foreign interest rates. The lower adjusted inflation, along with slower growth in food and regulated prices (resulting from a postponement of the increase in regulated rents), explains the lower-than-forecasted inflation during 2005. In 2006 Q1, regulated prices increased considerably faster than predicted by the October forecast (owing to an increase in prices of energy and telecommunication services) and, together with higher fuel prices, caused actual inflation to be close to the October forecast and hence to the CNB's point inflation target.

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 2004 H2 and 2005 Q1 (see the relevant minutes), the overall perception of the risks was slightly anti-inflationary (the July and October forecasts roughly neutral and the January forecast anti-inflationary). In line with this assessment, the Bank Board deviated somewhat towards lower rates from the recommendations of the forecast. One can say with the benefit of hindsight that some of the inflationary risks (e.g. the risk of a higher oil price) and most of the anti-inflationary risks (e.g. the risk of lower growth in external demand and higher growth in potential output) did subsequently materialise. The slightly anti-inflationary assessment of the risks in the key period and the ensuing slightly easier monetary policy compared to the original forecasts thus contributed to inflation being close to the point inflation target in 2006 Q1.

Table II.4

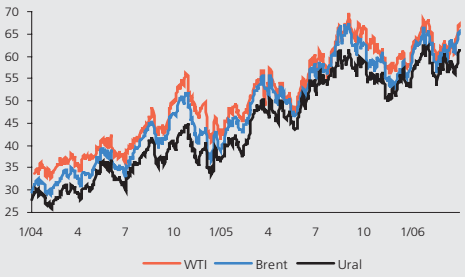
The koruna-euro exchange rate was stronger over the entire forecast horizon

		IV/04	I/05	II/05	III/05	IV/05	I/06
3M PRIBOR	prediction	2,7	2,7	2,8	3,0	3,2	3,3
(percentages)	outturn	2,6	2,3	1,9	1,8	2,1	2,1
CZK/EUR exchange rate	prediction	31,6	31,4	31,2	31,0	30,8	30,7
(levels)	outturn	31,1	30,0	30,1	29,7	29,3	28,6
GDP	prediction	4,5	4,5	4,3	4,5	4,6	4,1
(real, annual perc. changes)	outturn	5,0	5,3	5,8	5,8	6,9	-
Output gap	prediction	-0,4	-0,1	0,1	0,3	0,3	0,5
(percentages of GDP)	outturn[a]	-1,5	-1,2	-0,9	-0,6	-0,1	0,2

a) estimate based on the CNB's April 2006 forecast

III.1 THE EXTERNAL ENVIRONMENT

Chart III.1
The average price of WTI crude oil rose by more than 5% in 2006 Q1 compared to the previous quarter
(USD/barrel)

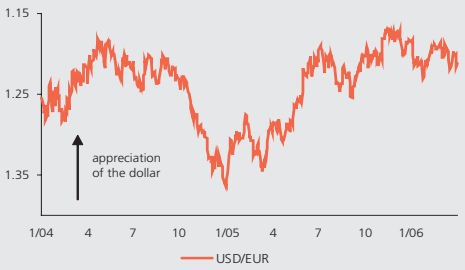


The rate of growth of the US economy eased slightly in 2005 Q4, but remained significantly higher than in the euro area, where growth did not even reach 2%. Growth in the countries of the Central European region continued to rise, with Slovakia and the Czech Republic remaining the fastest growing economies in the region. Compared to the previous quarter the US dollar depreciated slightly against the euro in 2006 Q1. The price of WTI crude oil fluctuated between USD 58 and USD 68 a barrel in this period, the average level being 5.5% higher than in Q4.

The US economy grew by 3.5% in 2005 as a whole, i.e. 0.9 percentage point less than a year earlier, but still well above the euro area level. The downturn was partly due to lower growth in 2005 Q4, when output rose by "only" 3.2%, whereas in previous quarters the growth rate had been almost one half of a percentage point higher. The slower growth was caused in particular by a downturn in domestic demand. The relatively high economic growth led to a decline in the unemployment rate to 4.7% in March. In 2006 Q1, this rate was down by almost one half of a percentage point from the same period a year earlier. Capacity utilisation also increased, reaching 81.2% in February. The good situation on the labour market also showed up in a pick-up in wages, which rose by 3.5% in 2006 Q1 from 2.8% in the previous quarter.

Consumer price inflation declined by 0.4 percentage point to 3.6% in February. The high energy prices of January and February thus had yet to pass through to inflation. Core inflation remained unchanged at 2.1%. Producer price inflation fell by 2 percentage points to 3.7%. The public budgets were rather more favourable in the first five months of the fiscal year 2006 than in the same period a year earlier. In contrast, the external balance of the USA worsened in 2005. The current account deficit reached USD 805 billion for 2005 as a whole, widening by USD 137 billion compared to the previous year. An increase in the trade deficit of almost USD 130 billion accounted for most of this result. The current account deficit exceeded 7% of GDP in 2005 Q4.

Chart III.2
The dollar depreciated by 1% in 2006 Q1 compared to the previous quarter



At the end of March the Fed increased its key rate by 0.25 percentage point to 4.75%, the second such change this year. The US central bank made this decision despite some slowdown in growth in Q4, assessing this development as a slowdown caused by only temporary factors. It considers the overall development of the domestic economy to be strong and accompanied by some inflationary pressures.

GDP growth in the euro area increased modestly from 1.6% in Q3 to 1.7% in Q4. A decline in household consumption growth was balanced by a more rapid rise in private investment and net exports and a slight increase in government expenditure. Although growth in economic activity for 2005 as a whole slackened from 2% to 1.4% compared to the previous year, signs of a renewed increase in output growth are strengthening. The unemployment rate fell by 0.1 percentage point to 8.2% in February, thus being more than one half of a percentage point lower than a year earlier. Year-on-year growth in industrial production reached 2.5% in the same month.

Consumer price inflation in the euro area continued to moderate slightly, falling to 2.2% in February. In the same month, owing to high energy prices, industrial producer prices rose by 5.4% year on year, the highest rate of growth recorded since 2000. What was surprising was the very low growth in consumer prices adjusted for food and energy prices – at 1.2% in January and February. Given the low wage growth, this suggests no emergence so far of second-round effects of the high oil prices. Core producer price inflation, which climbed to 1.7% in February, also suggests an absence of major inflationary pressures in the euro area.

Compared to Q3, the current account deficit widened by EUR 11 billion in Q4, to EUR 15 billion. A worsening of the current account is also visible by comparison with 2004 Q4, when a surplus of EUR 16 billion was recorded. However, this is not a result of a worsening of the euro area's competitiveness, but reflects the high oil and gas prices. At the beginning of March, the ECB increased its key rate by 0.25 percentage point to 2.5% on account of the risks to inflation, which the bank sees mainly in excessively fast money supply growth (M3 increased by 7.8% year on year in 2005 Q4 and the high growth has continued into 2006), increases in administered prices and indirect taxes. The bank is also trying to prevent the onset of second-round effects of the high oil prices.

Economic growth in Germany in 2005 picked up only negligibly – by 0.1 percentage point to 1.1% compared to the previous year. However, rising economic growth was apparent over the course of the year. The year-on-year rate of growth of GDP adjusted for seasonal and calendar effects was only 0.6% in Q1 and rose to 1.8% in Q4. In this quarter, growth in investment expenditure surged and strong export growth was maintained, while government consumption rose only negligibly. The higher growth was dampened by a decline in household consumption and higher import growth. Given the continuing weak consumer demand, high net export figures remained the engine of the German economy last year.

The current account surplus in Germany rose by EUR 4 billion compared to 2004, to EUR 160 billion. The favourable trend in the external sector has continued this year, with the January surplus of EUR 6 billion rising to EUR 11 billion in February. The main factor was a trade surplus of similar size. The high level of unemployment, which in March even increased slightly to 11.4% relative to February and December of last year, is also consistent with the subdued GDP growth. By contrast, consumer price inflation was favourable, falling to 1.9% in March and remaining several tenths of a percentage point below the euro area level this year.

Economic growth in the countries of the Central European region remained above 4% in Q4, i.e. more than double that in the euro area. Slovakia continued to grow the fastest, while Poland showed the lowest inflation. Trade balances and current accounts remained in deficit.

Hungary achieved economic growth of 4.1% in 2005, down slightly from the previous year. This growth was due mainly to rising net exports, whereas household consumption growth fell because of high interest rates and growing unemployment. In Q4, GDP growth declined by 0.2 percentage point to 4.3% compared to 2005 Q3, as a result of declining investment and household consumption growth. The robust economic growth manifested itself in high labour productivity growth and a double-digit increase in industrial production. At the same time, however, the unemployment rate has risen by a tenth of a percentage point this year and is around one percentage point higher than in the same period of last year.

Consumer price inflation in Hungary declined to 2.3% in March, as a result of a VAT reduction of 4 percentage points. However, producer price inflation also declined relative to the end of the previous year. The favourable trade balance development was reflected in a decline in the current account deficit and the trade deficit as a percentage of GDP last year. The Hungarian central bank has left its key rate unchanged at 6%, the highest level in the EU, since September 2005. The bank regards it as necessary to maintain this level because of the threat to the exchange rate posed by the high public budget deficit, dependence of the balance of payments on debt capital and the downgrading of Hungary's foreign currency rating.

Polish GDP rose by 3.2% in 2005, much more slowly than a year earlier, when it grew by 5.4%. The year-on-year growth rate rose over the individual quarters last

Chart III.3
Economic growth in the euro area picked up in 2005 H2
(annual percentage changes)

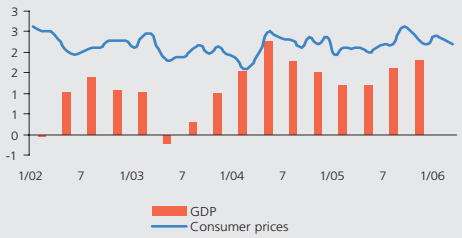
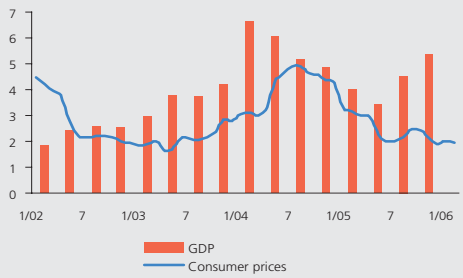


Chart III.4
In the "new" EU Member States, GDP growth increased and inflation remained low at the start of 2006
(annual percentage changes)



year, reaching 4.2% in Q4 thanks mainly to an almost 10% increase in investment. The growth was also supported, albeit to a much smaller extent, by growing household consumption. The contribution of net exports was negative, after having long functioned as the engine of the Polish economy. The unemployment rate fell by 0.2 percentage point to 17% in February, down by one percentage point from the same period a year earlier.

Annual consumer price inflation was below the 1% level for the third consecutive month, with producer prices and core inflation also rising very slowly. This was due to appreciation of the exchange rate coupled with low wage growth relative to the high growth in labour productivity. Given the very low inflation and the absence of inflationary pressures, the Polish central bank's Monetary Policy Committee has cut its key rate by 0.25 percentage point twice this year, to 4%.

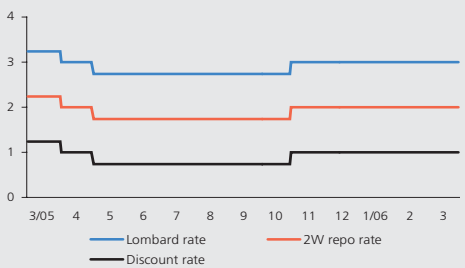
The Slovak economy grew by a high 7.6% year on year in Q4 and by 6% for 2005 as a whole, thus becoming the fastest growing economy in the region together with the Czech Republic. The growth was a result of rapidly rising domestic demand, most notably investment demand. The GDP growth rate was slowed by a net export deficit. The trade deficit as a percentage of GDP even exceeded the 9% level in Q4, worsening by several percentage points compared to the previous quarter. This deficit was a result not of declining exports, which, on the contrary, recorded double-digit growth, but of extreme growth in imports, a natural consequence of the very high investment.

The strong domestic demand also generated higher growth in the price level. Consumer price inflation jumped to 4.5% in March, giving Slovakia the highest inflation in the region. This growth was due to food, energy and regulated prices. Core inflation increased to 2.2%. Industrial producer price inflation increased to almost 10% in March, continuing on an upward path that has been ongoing for more than a year now. The strong economic growth also manifested itself in high growth in industrial production and real wages. At the end of February, the NBS responded to the growing inflationary pressures by raising its key rate by 0.5 percentage point to 3.5%.

III.2 THE MONETARY CONDITIONS

According to CNB's calculations, the settings of the real monetary conditions in 2006 Q1 can be characterised as slightly tight. The tightness was largely due to the exchange rate component. By contrast, the interest rate component was neutral to slightly easy.[9] The evolution of the two components of the monetary conditions in 2006 Q1 is described in more detail below.

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



III.2.1 Interest rates

The decline in financial market interest rates that emerged at the end of 2005 continued roughly until the end of February 2006. However, the rate of decline differed depending on maturity. In the case of short-term rates the downward trend was very pronounced. The decline in rates with longer maturities was partly

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

subdued by developments on euro area markets, which saw mounting speculation about a tightening of monetary policy by the ECB; nonetheless, these rates also saw a modest decrease. The main factor behind the fall in rates was the appreciating exchange rate of the koruna, which tightened the overall monetary conditions. The strong koruna and a potential interest rate reduction were also the subject of comments made by several CNB Bank Board members. On the basis of these comments, part of the market therefore started speculating that the CNB Board would lower key rates at its meeting on 23 February.

However, the 2W repo rate remained at 2%, the Lombard rate at 3% and the discount rate at 1%. The CNB's decision not to change the monetary policy settings and the surprising – according to the market – ratio of the votes (5:1 for leaving rates unchanged) triggered a gradual rise in rates across all maturities. Following the raising of the ECB's key rates (on 2 March) the negative interest rate differential vis-à-vis euro rates widened further. The koruna reacted to this by depreciating slightly. In this situation, all speculation on a potential reduction of the CNB's key rates subsided. PRIBOR spot quotations and FRA forward quotations at the end of March 2006 indicated that the majority of the financial market expected a monetary policy tightening to occur roughly in 2006 Q3.

The PRIBOR yield curve shifted to a lower yield level until the end of February and its positive slope decreased at the same time. There followed a partial correction and the spread between the 1Y PRIBOR and 2W PRIBOR again increased slightly. In March, the spread was 0.30 percentage point. The IRS yield curve followed a similar pattern. In March, the average 5Y-1Y spread was 0.87 percentage point and the 10Y-1Y spread 1.25 percentage points.

The evolution of the interest rate differential on the money market (PRIBID/CZK-LIBOR/EUR, USD) was affected by changes in key rates and movements in interbank market rates. Key rates increased in both the most important economies. The Fed continued increasing its key O/N rate (in two steps to 4.75%). The ECB raised its refinancing operations rate to 2.50%. The interest rate differential vis-à-vis euro and dollar rates was negative at all maturities.

Six auctions were held on the primary government bond market, with original maturities of 3Y–15Y and a total volume of CZK 38.2 billion. All auctions were successful, with demand always exceeding supply. In addition to domestic issues, there was an issue of bonds denominated in Japanese yen, with a maturity of 30Y, a volume of CZK 6.2 billion and a coupon of 2.75%. In January, Fitch Ratings affirmed the Czech Republic's long-term foreign currency rating at A and its local currency rating at A+ with a stable outlook. At the end of March, Moody's upgraded the Czech Republic's rating outlook from stable to positive.

The evolution of interest rates on the financial market is also reflected in client interest rates. Nominal interest rates on new loans were 5.5% and rates on new time deposits 1.7% in February. Real interest rates[10] are affected not only by the level of nominal rates, but also by movements in inflation expectations. Expected consumer price indices are traditionally higher than expected industrial producer price indices. This fact is reflected in the levels of the individual real interest rates. Real rates on new loans were 4.3% in February, while real rates on time deposits were -0.8%.

Chart III.6
Market interest rates started rising in February
(percentages)

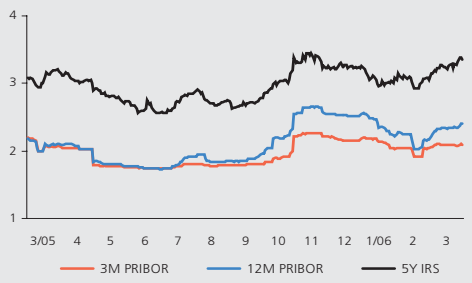


Chart III.7
The interest rate differentials of the koruna vis-à-vis the euro and the dollar fluctuated in negative values
(percentage points)

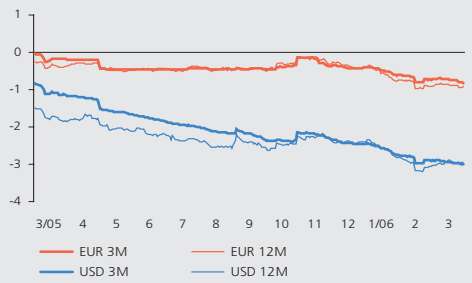
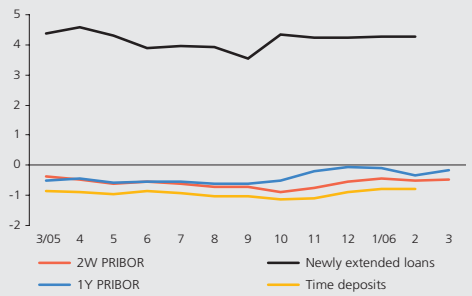


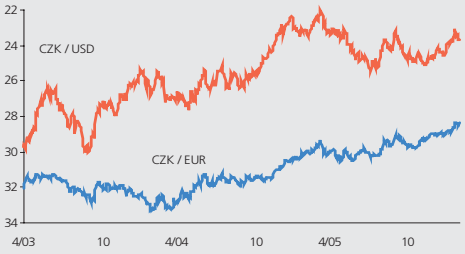
Chart III.8
Ex ante real interest rates on new loans remained flat above 4%
(percentages)



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

III.2.2 The exchange rate

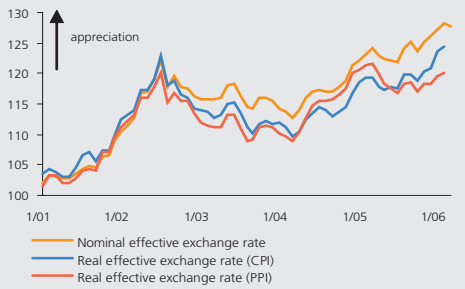
CHART III.9
The koruna appreciated against the euro and the dollar in 2006 Q1



The average exchange rate of the koruna against the euro was CZK 28.6/EUR in 2006 Q1, which represents a year-on-year appreciation of 4.7% (and a quarter-on-quarter appreciation of 2.4%). The appreciation trend which started in 2004 Q2 thus continued. This was due primarily to the favourable evolution of the economy and in particular to the decreasing current account deficit and foreign short-term investors' positive view of the Central European region. The appreciation was moderated by a negative, and moreover widening, interest rate differential vis-à-vis most major world currencies. All the Central European currencies continued to appreciate. In Q1, however, the Czech koruna (together with the Slovak koruna) saw the strongest quarter-on-quarter appreciation, despite its relatively wide negative differential vis-à-vis the other currencies in the region (the Polish zloty, the Hungarian forint and the Slovenian tolar). The March trend towards some moderation of the appreciation pressures on the koruna may be related to the widening of the negative differential vis-à-vis the euro and possibly also the dollar, to advance foreign currency purchases by some major companies for payments of dividends abroad, or to a revision of the investment outlook in developing markets as a result of rising bond yields in the USA and the euro area.

In 2006 Q1, the average exchange rate of the koruna against the dollar was CZK 23.8/USD, which represents a year-on-year depreciation of 3.8% (but a quarter-on-quarter appreciation of about 3.6%). This change in trend (in Q3 the koruna showed a year-on-year appreciation of 6.0% against the dollar) was due to the evolution of the dollar exchange rate on world markets. After several years of weakening against all major currencies, the dollar first stopped depreciating then even appreciated slightly (between March and November 2005), stabilising at roughly USD 1.2/EUR thereafter. The halting of the depreciation and the subsequent appreciation of the dollar was related mainly to changes in the interest rate differential 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. In recent months, however, the continuing growth in rates has had no major effect on the dollar-euro exchange rate (probably because of the improving prospects for the euro area, including expectations of higher rates).

CHART III.10
The nominal effective exchange rate continued to show year-on-year growth in 2006 Q1
(year 2000 = 100)



The nominal effective exchange rate of the koruna appreciated by 3.8% year on year in 2006 Q1 (but by only 2.9% in March 2006), owing mainly to the koruna's year-on-year appreciation against the euro. This appreciation was moderated above all by the koruna's exchange rate against the dollar, the zloty and the Slovak koruna. Owing to the aforementioned evolution of the koruna's nominal exchange rate, the year-on-year appreciation of the real effective exchange rate deflated by the CPI moderated as well (to 4.3% in February 2006). By contrast, the year-on-year development of the real effective exchange rate deflated by the PPI differed significantly from the evolution of both the nominal and real effective exchange rate deflated by the CPI. Owing to substantially lower industrial producer price inflation in the Czech Republic than in other countries, the PPI-deflated real effective exchange rate showed a gradually decreasing annual appreciation last year and has been weakening since December. In February 2006, the annual depreciation was about 1%.

III.3 THE BALANCE OF PAYMENTS

III.3.1 The current account

The current account ended 2005 in a deficit of CZK 61.7 billion, or 2.1% of GDP. This was the lowest deficit since 1999. Adjusted for reinvested earnings of non-

residents, the current account would have shown a modest surplus. The year-on-year improvement in the current account amounted to CZK 105.6 billion. The improvement concerned all current account items, but mostly reflected a trend improvement in the trade balance.

The trade surplus amounted to CZK 40.4 billion in 2005, a year-on-year improvement of CZK 66.8 billion. This was due exclusively to a rising physical volume of exports (which showed roughly double the growth rate recorded by imports) amid a year-on-year worsening of 1.7% in the terms of trade. The annual trade balance improvement again chiefly reflected changes in the SITC 7 category (machinery and transport equipment), where the surplus increased by CZK 80.8 billion. A year-on-year improvement was, however, also apparent in other categories – manufactured goods (SITC 6), miscellaneous manufactured articles (SITC 8), chemicals (SITC 5) and food (SITC 0). The overall improvement in the balances in these categories exceeded CZK 20 billion. The trade balance improvement is attributable to changes on the supply side (direct investment and relocation of production to the Czech Republic), reflected in a rise in the physical volume of exports. The improvement was offset by a marked deterioration of CZK 40.2 billion in the SITC 3 category (mineral fuels). Around three-quarters of this was due to a price effect related to year-on-year growth in oil and natural gas prices, while the rest was caused by a rise in the physical volume of imports (particularly an increase in the national oil reserves).

From the geographical perspective, the trade balance improvement was again due primarily to an increase in the trade surplus with the EU (of CZK 53.7 billion to CZK 278.1 billion). The balance with another important trading partner, the USA, improved as well (by more than CZK 16 billion), thanks mainly to rising exports. The deficit thus changed into a modest surplus. The trade deficits with Japan and China remained virtually unchanged, showing a modest improvement in the case of Japan and a slight deterioration in the case of China. Among the Czech Republic's major partners, only the trade balance with Russia deteriorated (by about CZK 24 billion). The adverse effect of rising oil and natural gas prices and imports on the balance with Russia was, however, largely offset by a rise in Czech exports.

Nonetheless, the trade balance showed a surplus of only CZK 0.5 billion in Q4 (up by CZK 11.5 billion on a year earlier). The main cause of the lower trade surplus and the smaller year-on-year improvement therein in Q4 was a continuing deterioration in the terms of trade to -4.3% (from -2.9% in Q3).

The trend of a decreasing surplus on the balance of services halted after three years, with the surplus slightly improving in 2005 (by CZK +6.9 billion to CZK 19.4 billion). An increase in surplus was apparent especially in travel (of CZK 4.3 billion, due mainly to higher receipts). Transport also recorded a minor improvement in balance (of CZK 1.9 billion). The negative trend recorded for other services halted as well. This was particularly visible in Q4. Thanks to this improvement, the overall surplus on services saw another modest year-on-year improvement in Q4.

The income deficit decreased slightly year on year (by CZK 15.4 billion to CZK 142.3 billion, of which reinvested earnings are estimated at around CZK 80 billion). However, this is comparing the definitive figures for 2004 with preliminary data for 2005. Should the situation of previous years be repeated, the deficit may increase as a result of revisions to the data (in particular non-residents' direct investment earnings). The rising deficit on compensation of employees and non-residents' growing direct investment earnings from their increasing asset holdings in the Czech Republic (as a result of the sale of four major companies) also fostered a widening of the income deficit. By contrast, increasing income from holdings of foreign debt securities helped to moderate the deficit.

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

	2002	2003	2004	2005
A. Current account	-136.4	-160.6	-167.3	-61.7
Trade balance	-71.3	-69.8	-26.4	40.4
Services	21.9	13.2	12.5	19.4
Income	-115.6	-119.9	-157.8	-142.3
Transfers	28.7	15.8	4.3	20.9
B. Capital account	-0.1	-0.1	-14.0	5.1
C. Financial account	347.8	157.1	183.7	137.9
Direct investment	270.9	53.5	101.8	242.7
Portfolio investment	-46.7	-35.7	59.4	-72.0
Financial derivatives	-4.3	3.9	-3.2	-2.8
Other investment	127.9	135.5	25.7	-30.0
D. Errors and omissions	5.6	16.5	4.5	11.5
Change in reserves (- = increase in reserves)	-216.9	-12.9	-6.8	-92.9

Chart III.11
The annual moving total of the trade surplus further increased in 2005 Q4
(CZK billions)

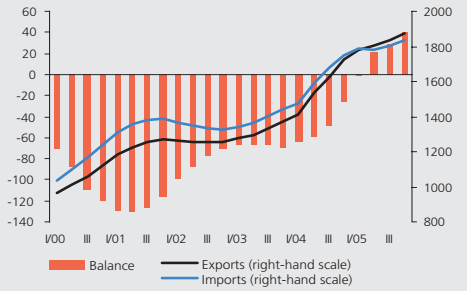
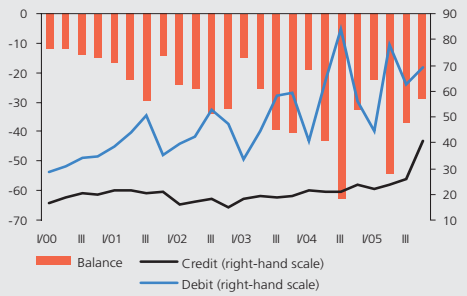


Chart III.12
The income deficit decreased moderately year on year in 2005 Q4
(CZK billions)



Current transfers ended in a surplus of CZK 20.9 billion, up by CZK 16.6 billion on a year earlier. However, this improvement was due exclusively to damages paid by the Slovak Republic to CSOB for losses dating from the division of Czechoslovakia under an international arbitration decision (CZK 19.4 billion). Adjusted for this transaction, the current transfers balance continued to record the moderate year-on-year deterioration observed since 2002. In 2005, this was caused by a worsening of the Czech Republic's balance in relation to the EU budget. In Q4, the current transfers surplus was CZK 5.1 billion; adjusted for the effect of Slovakia's second payment of damages to CSOB, however, the current transfers balance would have turned into a modest deficit.

III.3.2 The capital account

The capital account ended 2005 in a surplus of CZK 5.1 billion (compared to a deficit of CZK 14.0 billion in 2004). This year-on-year improvement was, however, almost exclusively due to the fact that the 2004 capital account had included an accounting operation associated with the de-blocking of foreign assets. Adjusted for this one-off effect, the capital account was almost unchanged. The capital account is traditionally affected mainly by drawings from the EU Structural Funds.

III.3.3 The financial account

The financial account showed a surplus of CZK 137.9 billion in 2005, i.e. 4.7% of GDP (compared to a surplus of CZK 183.7 billion in 2004). The year-on-year decline in the financial account surplus resulted primarily from a change in portfolio investment flows, affected to a certain extent by monetary policy, and an increased outflow of capital via the banking sector (a decline in foreign currency demand related to current account developments).

Direct investment recorded a surplus of CZK 242.7 billion, representing a sizeable annual rise in net inflow (of CZK 140.9 billion). The inflow of foreign direct investment (including reinvested earnings) was CZK 262.8 billion, a year-on-year rise of CZK 136.4 billion. Sales of property to non-residents (Telecom, TV Nova, Unipetrol and Vítkovice) accounted for most of the FDI; their total selling price, including subsequent purchases of Telecom shares from minority shareholders, was almost CZK 150 billion. Reinvested earnings of non-residents again slightly increased and are estimated at CZK 78 billion. Except for the major sales of property mentioned above, the foreign capital inflow continued falling slightly year on year, amounting to about CZK 40 billion. It was channelled primarily into real estate (about 61%) and industry (about 25%). The biggest investors were the Netherlands, the United Kingdom, Germany, Luxembourg and Switzerland. Czech direct investment abroad stood at CZK 20.1 billion. It was strongly affected by a one-off financial transaction of almost CZK 10 billion and by a ČEZ acquisition.

The net outflow of portfolio investment was CZK 72 billion, contrasting with the net inflow of CZK 59.4 billion recorded in the same period of 2004. The year-on-year change in capital flows of more than CZK 130 billion was most influenced by non-residents' declining interest in domestic koruna-denominated debt securities and also in shares. To a small extent there was also a rise in residents' interest in investing in foreign debt securities. The change in debt capital flows was probably due primarily to the evolution of the interest rate differential between the koruna and the major world currencies. A decline in holdings of domestic shares by non-residents was greatly affected by the one-off purchase of foreign portfolio investors' Telecom shares by the Spanish company Telefonica (a shift of around CZK 20 billion to direct investment).

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

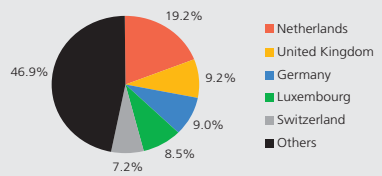
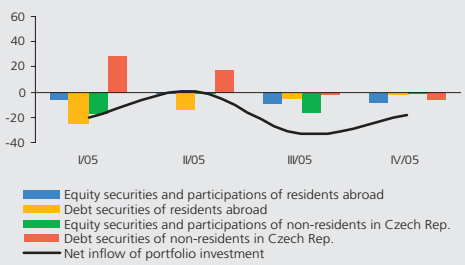


Chart III.14
The net portfolio investment outflow from the Czech Republic abroad decreased in 2005 Q4
(CZK billions)



Roughly two-thirds of the capital outflow of CZK 72.8 billion was attributable to increasing holdings of foreign bonds by residents (shares accounted for about one-third). Although the interest rate differential vis-à-vis most major currencies was negative for almost the entire 2005, residents' interest in foreign debt securities increased only slightly year on year and growth in bond holdings was even lower than in 2002 and 2003. Residents' holdings of foreign securities totalled almost CZK 430 billion at the end of 2005, with bonds accounting for about three-quarters of this figure. Geographically, holdings of European securities (most notably from EU countries) predominated.

The inflow of portfolio investment from abroad was only CZK 0.8 billion. The virtual absence of inflow was chiefly a result of a CZK 36.4 billion decline in domestic shares held by non-residents. This decline was mostly related to the aforementioned technical transfer of part of portfolio investment to direct investment, and, to a lesser extent, to the exit of short-term investors to stock markets with greater growth potential. The year-on-year decrease in growth of domestic bonds held by non-residents (from CZK 103.7 billion to CZK 37.3 billion) was mostly due to the evolution of the interest rate differential. However, the declining interest in purchases of domestic bonds was offset by a CZK 30 billion government bond issue (in euros) on a foreign market. Total Czech portfolio investment held by non-residents was almost CZK 440 billion at the end of 2005, with shares accounting for about half this total. As for bonds (the remaining half), residents' issues on foreign markets slightly exceeded domestic ones. Government/public sector bonds played a dominant role.

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

Other investment recorded a net capital outflow of CZK 30 billion. Short-term operations by the banking sector are the major item affecting other investment. 2005 saw an outflow of capital via banking sector operations of more than CZK 90 billion, about three-quarters of which involved short-term operations (growth in short-term assets). The growth in assets was greatly affected by the aforementioned damages paid to CSOB and retained in Slovakia, and also by exchange rate hedging of a government Eurobond issue on the European market. The net capital outflow under other investment was offset by capital inflows amounting to CZK 34.9 billion via the government sector (in particular loans from the EIB for the construction of infrastructure, a loan for the purchase of fighter aircraft and the de-blocking of assets) and borrowing by the business sector totalling CZK 26.8 billion (mostly long-term loans).

In 2005, the CNB's international reserves increased by CZK 92.9 billion (to CZK 726.7 billion), mostly as a result of transactions to eliminate the impacts of the sale of the state-owned stake in Telecom on the foreign exchange market. In 2006 Q1, the international reserves fell by CZK 24.0 billion to CZK 702.7 billion. This was due mostly to valuation changes. In dollar terms, the reserves have increased by USD 0.1 billion since the start of 2006, to USD 29.7 billion.

CHART III.15
The international reserves increased moderately in dollar terms in 2006 Q1
(USD billions)

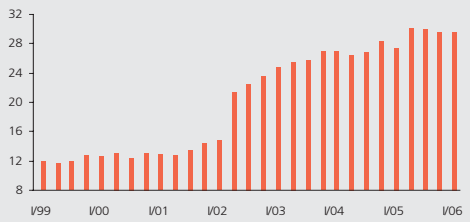
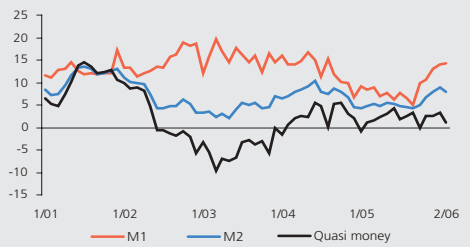


CHART III.16
M2 growth increased
(annual percentage changes))



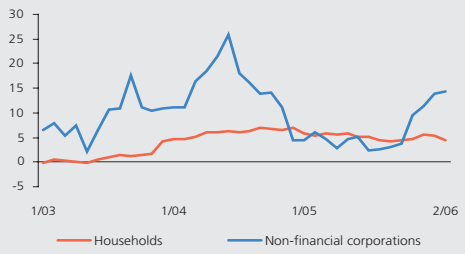
III.4 MONETARY DEVELOPMENTS

Money supply growth accelerated in 2005 Q4, owing to higher deposits by non-financial corporations. The low level of nominal interest rates continued to encourage demand by economic agents for liquid money. The favourable financing conditions were reflected in rising loans to corporations and particularly to households. Mortgage loans with long maturities continued to increase.

III.4.1 Money

M2 growth picked up in 2005 Q4. This trend continued into January 2006 and then saw a partial correction in February. Annual M2 growth was 7.9% in February (see Chart III.16). The annual rate of growth of M2 adjusted for exchange rate movements and other non-transaction effects followed a similar pattern and was 8.1% in February. In Q4 and in 2005 as a whole, M2 moved broadly in line with GDP growth. Growth in deposits by non-financial corporations saw a marked increase owing to higher earnings from export activities and improved profitability of corporations in Q4, although the pre-tax profit of non-financial corporations with 100 employees or more decreased slightly in 2005 as a whole. Following a pick-up in Q4 (corresponding to growth in the gross saving rate and more subdued growth in consumption) and a stagnation in January, household deposit growth slowed in February (see Chart III.17).

Chart III.17
Deposits by non-financial corporations grew in particular
(annual percentage changes)



The M2 growth was chiefly attributable to M1, whose annual growth increased throughout the period under review, reaching 14.2% in February (see Table III.2). This trend was visible for overnight deposits by non-financial corporations and, to a lesser extent, households. The rate of growth of currency in circulation also picked up. In February, the share of M1 in M2 increased to a new historical high of 55.3%. This suggests that the low interest rates, implying low opportunity costs of holding money, are supporting persisting demand by economic agents for liquid money. Within M1, the opportunity costs of holding liquid money, as expressed by the spread between the interest rate on new deposits with an agreed maturity of up to one year and the rate on overnight deposits, were about 1 percentage point for non-financial corporations and households in February. Only the spread between the rate on household deposits redeemable at notice of up to three months and the rate on overnight deposits was higher (1.9 percentage points).

Table III.2
M1 and, within its structure, O/N deposits accounted for most of the money growth
(quarterly averages and end-of-month stocks; annual percentage changes)

	II/05	III/05	IV/05	1/06	2/06	Outstanding amount as % of M2 2/06
M1	7.0	6.4	11.1	13.9	14.2	55.3
Currency in circulation	8.2	8.3	10.3	10.1	9.9	13.3
Overnight deposits	6.5	5.7	11.4	15.2	15.6	42.0
M2-M1 (quasi money)	3.2	2.6	1.7	3.2	1.1	44.7
Deposits with agreed maturity	2.1	0.7	-1.2	-0.8	-2.3	33.2
Deposits redeemable at notice	10.3	10.5	11.5	12.5	8.8	10.9
Repurchase agreements	-46.7	-9.9	11.6	129.1	138.1	0.6
M2	5.1	4.5	6.6	8.9	7.9	100.0

Annual growth in quasi money slowed in Q4, rose in January and then fell back to 1.1% in February. This was reflected in weaker M2 growth in February. In year-on-year comparison, there was a faster decline in deposits with agreed maturity and slowing growth in deposits redeemable at notice, particularly in the case of households. As regards non-financial corporations, the volumes in both these categories declined. Conversely, within quasi money there was continued high growth in repos by non-monetary financial institutions, comprising insurance companies, pension funds and other financial intermediaries, but their share in the money stock was very low.

A rise in the annual rate of growth of net foreign assets to 21.6% and a negligible increase in loans to corporations and households to 20.8% were the main factors behind the stronger annual M2 growth. The growth in net foreign assets was linked mainly with the current account developments and, in January, with investment by non-residents in government securities and a decline in deposits received from non-resident banks. The rise in money supply growth was also fostered by a decrease in the negative annual rate of growth of net credit to the government, to -63%. This reflected a year-on-year deterioration in the state budget deficit in Q4. In year-on-year comparison, the negative annual rate of growth of net credit to the government was affected above all by the improving position of the Czech Consolidation Agency resulting from the sale of receivables.

III.4.2 Credit

Annual growth in loans to corporations and households was almost unchanged in Q4, picked up moderately in January and then fell back slightly to 20% in February (see Table III.3). These movements were accompanied by a rise in the interest rate on new loans to 5.5% in Q4 and a stagnation in January and February.

Table III.3
Growth in lending to corporations and households remained high
(quarterly averages and end-of-month stocks; annual percentage changes)

	II/05	III/05	IV/05	1/06	2/06	Outstanding amount as % of total loans 2/06
Non-financial corporations	11.4	12.9	12.3	15.1	14.6	49.9
Loans up to 1 year	7.3	12.9	10.1	13.9	11.7	20.0
Loans over 1 year and up to 5 years	19.1	14.0	13.8	10.7	12.1	12.1
Loans over 5 years	11.0	11.9	13.9	19.9	19.9	17.8
Households	32.6	33.2	33.0	33.2	33.4	39.2
Consumer credit	31.1	32.1	31.5	33.0	33.2	8.2
Loans for house purchase	34.7	35.9	35.0	34.8	35.0	26.7
Other loans	23.5	20.6	24.2	24.4	24.9	4.3
Non-monetary financial institutions	1.7	6.6	5.2	4.9	5.0	10.9
Total loans	16.8	19.0	19.1	20.2	20.0	100.0

Loans to non-financial corporations followed a similar pattern to total loans: their growth slowed in Q4 and stood at 14.6% in February (13.1% for domestic corporations and 18.7% for foreign-controlled corporations). Despite the slower growth in loans to corporations, their net annual flow increased in Q4 and, according to balance of payments data, was accompanied by higher borrowing from abroad, partly correcting the trend of previous quarters. These were predominantly loans with maturities of more than one year. The above developments may have resulted from the fact that interest rates on new loans to corporations in the euro area were lower than those in the Czech Republic (except for bank overdrafts and loans of over EUR 1 million with short rate fixation). However, borrowing from abroad amounted to only about one-third of that from domestic sources, which confirms the growing significance of domestic loans in financing corporations' economic activities (see Chart III.18).

Turning to the sector structure, loans to branches of manufacturing and services, i.e. trade, maintenance and repair, were the biggest contributors to the total loan growth, although their contribution fell somewhat in Q4. Also significant was the contribution of loans to the machinery and equipment rental sector and loans to the transport and storage industries. Manufacturing, services and machinery and equipment rental have been significant contributors to the growth in loans over the past two to three years, in line with the structural changes in the economy. Turning to maturity, Q4 saw a decline in short-term loan growth. Nonetheless, the growth in these loans remains high, since, given the low interest rate levels, corporations are financing part of their operating needs from external sources. Domestic and foreign-controlled non-financial corporations both continued to employ long-term koruna loans, whose growth picked up in the period under review. The internal funds of non-financial corporations also increased in 2005 Q4, thanks to improving profitability. According to statistics on the financial performance of corporations with 100 employees or more, corporations' total external funds (i.e. including bond issues, intercompany debts, etc.) increased in 2005. This resulted in a modest rise in the corporate debt to GDP ratio, to 61.2%.

Annual growth in loans to households slowed in Q4 and then went up in January and February 2006, reaching 33.4%. This increase was again attributable mainly to mortgage loans with long-term maturities. The rate of growth of building society loans decreased. The relatively strong growth in consumer credit, visible roughly since mid-2004, persisted, although the growth rate decreased in Q4 in line with the more subdued growth in household consumption. In 2005, the ratio of household loans to GDP rose by 2.9 percentage points to 14.3%, but is still lower than in the euro area, where the analogous ratio exceeds 50% (see Chart III.19). Total financial liabilities form more than one-third of households' financial assets. According to the quarterly national accounts, growth in the annual flow of financial assets exceeded that of financial liabilities in 2005, owing to funds placed in insurance technical reserves. Within the structure of the annual flow of financial liabilities there was primarily a rise in loans, with MFI loans again accounting for more than 90%. The proportion of loans from other financial intermediaries or other lending companies was less significant. The absolute volume of these loans was CZK 49.4 billion at the end of 2005 (compared to CZK 428 billion in loans from MFIs), 98% of which was provided to finance consumption expenditure. The volume of loans to households from financial leasing companies reached CZK 49.7 billion in the same period, with loans for consumption accounting for 79% of this total.

The debt burden of households was again favourably affected by the low interest rates. According to the CZSO's household budget survey for 2005 Q1-Q4, the debt burden (as measured by the ratio of repayments/instalments to money income) per person increased by 0.2 percentage point to 4.2% of net money income, and by 0.1 percentage point to 3.5% of gross money income, although it fell slightly in Q4 alone. A significant factor as regards the implications for the consumption

Chart III.18
Domestic borrowing by non-financial corporations increased
(annual flows; CZK billions)

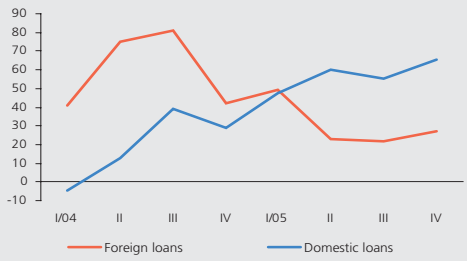


Chart III.19
The ratio of MFI loans to households to GDP remained significantly lower than in the euro area in 2005
(percentages)

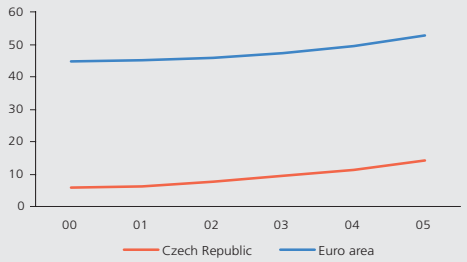


Chart III.20
Despite increasing, the interest rate on new housing loans remained low
(percentages)

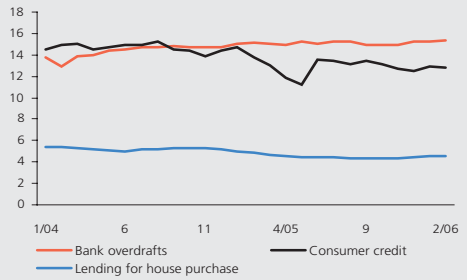
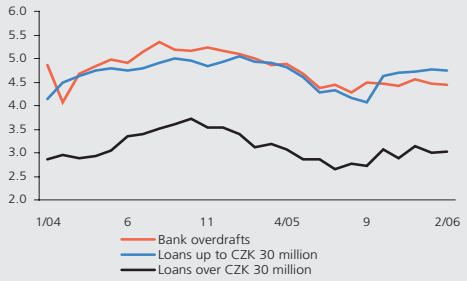


Chart III.21
Interest rates on new loans to non-financial corporations mostly increased
(percentages)



behaviour of households is the debt breakdown by household income groups, as rising debt can affect consumption and increase its sensitivity to various shocks differently across the individual groups (see Box).

The overall interest rate on new loans to non-financial corporations and households increased by 0.4 percentage point in Q4 and then remained flat at 5.5% in January and February. The rise in the rate on loans was affected by the October increase in the CNB's key rates and by expectations of a further increase at the start of December 2005. In Q4, the strongest growth was recorded by rates on loans for house purchase with long fixation, and in December alone also by rates on loans for house purchase with short fixation and furthermore for rates on loans to non-financial corporations. By contrast, rates on consumer credit decreased in the period under review, particularly at the end of the year. Rates on bank overdrafts increased only for households, but their link to the monetary policy rate is generally weaker.

Chart 1 (Box)
The volume of loans is highest among households with the highest incomes
(loans received and hire purchase; annual per capita averages in CZK)

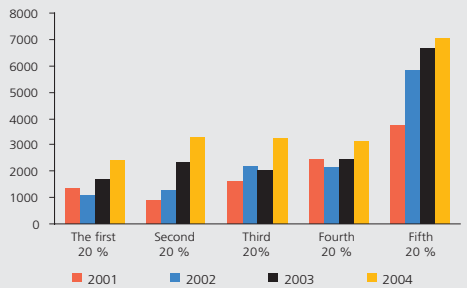
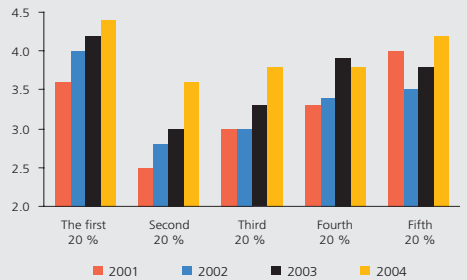


Chart 2 (Box)
Growth in the debt burden was significant among low-income households
(ratio of loan repayments and instalments to net money income; annual per capita averages in percentages)



BOX
Implications of household debt for consumption

Household debt and household consumption are closely interlinked. In the long run, which this Box concentrates on, rising debt may slow consumption and increase its sensitivity to various shocks.

In the case of a higher debt burden, households can avoid a decline in their consumption primarily by reducing their savings. However, households with lower money incomes usually have limited options in this respect, as they have lower savings than households with higher incomes (in 2004 the ratio of new saving deposits to net money income was 1.8% among the 20% of households with the lowest incomes, while the figure for households with the highest incomes was 11.4%).[11] The implications of debt for consumption and higher sensitivity of consumption to potential shocks (e.g. a change in interest rates or a change of employment) are therefore most probable for low-income households.

Charts 1 and 2 (Box) show the debt burden of households by income group in more detail. Chart 1 reveals that the highest absolute volume of newly received loans and hire purchase in 2001–2004 was recorded for households with the highest incomes. On the other hand, Chart 2 shows that the debt burden on households with the lowest and highest incomes was much higher than that on medium-income households in the same period. However, the strongest growth in debt burden occurred in the first, second and third groups of households.

Another channel through which debt can affect consumption relates specifically to loans for house purchase. Whereas households with high incomes are generally able to borrow up to 100% of the purchase price of the property they want to buy, households with lower money incomes usually have to finance part of the purchase price from their own sources. A one percentage point rise in debt burden in the area of loans for house purchase will thus generally have a greater downward effect on the consumption of low-income households than high-income

[11] The data were obtained from a selected basic set of the CZSO's annual household budget survey statistics comprising 3,000 households. The households are broken down into five groups by net money income per person.

households. It is reasonable to assume that loans for house purchase are taken out mainly by high-income households and hence that this effect does not play a major role at present. Nonetheless, certain tendencies supporting this effect can be observed in the structure of gross money expenditure, where all income groups of households except for the highest-income group have in recent years recorded a decreasing share of expenditure on consumption and a rising share of expenditure on property purchases/reconstructions. Households with the highest incomes have shown the opposite trend.

To sum up, the observed rise in debt so far suggests potential impacts primarily on consumption by households with lower money incomes.

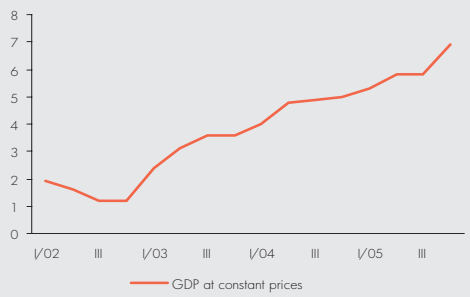
III.5 DEMAND AND OUTPUT

Economic growth rose sharply in 2005 Q4, reaching a historical high for the growth phase of the Czech economy ongoing since 2003. Compared to the previous quarter, annual real GDP growth picked up by 1.1 percentage point to 6.9%. GDP formation increased by 6% for the whole year.[12] According to the CNB's latest estimate, the output gap has closed owing to the higher-than-expected growth.[13]

On the demand side, a sizeable increase in net exports made the largest contribution (of almost three-quarters) to the rapid GDP growth. The favourable net exports were due mainly to an improved trade balance, with goods exports rising more than twice as fast as goods imports. The buoyant growth in real goods exports was supported particularly by structural changes on the supply side, which were connected with the construction of new export-oriented production facilities. The improvement in net exports was also fostered by a slowdown in the growth of goods imports, which resulted in a reduced import intensity. As in the previous quarter, the contributions of consumer demand and fixed investment were the main domestic demand factors behind the GDP growth. Amid slightly falling final consumption expenditure at the end of 2005, the government sector did not contribute to GDP growth.

As a result of the structural changes ongoing on the supply side, manufacturing was the largest contributor to GDP growth in Q4. The services sector also made a major contribution. Overall, most sectors of the economy contributed to the economic growth at the end of 2005.

CHART III.22
Economic growth rose sharply to 6.9% in 2005 Q4
(annual percentage changes)



III.5.1 Domestic demand

Annual growth in final domestic demand eased to 1.6% in 2005 Q4. All its components contributed to this development. The largest slowdown was recorded in government final consumption expenditure, but this was due largely to a one-off expenditure item[14] in the previous quarter. A fall in household consumption growth to 2.6%, which accounts for roughly 70% of final domestic demand, was also

TABLE III.4
Annual growth in final consumption expenditure slowed in 2005 Q4
(annual percentage changes; CZK billions)

	2004 Q1	2004 Q2	2004 Q3	2004 Q4	2005 Q1	2005 Q2	2005 Q3	2005 Q4
Gross domestic product	4.0	4.8	4.9	5.0	5.3	5.8	5.8	6.9
Final consumption expenditure	1.9	2.2	1.1	0.7	1.0	2.2	3.4	1.6
of which:								
Household consumption	4.1	3.2	3.0	2.8	2.1	2.8	2.9	2.6
Government consumption	-2.8	-0.2	-3.5	-4.0	-1.4	0.8	4.6	-0.6
Non-profit institutions serving households	7.6	10.5	13.6	13.5	3.5	2.9	0.4	0.8
Gross capital formation [a)]	10.6	9.7	8.2	2.8	-0.4	-2.5	-0.4	4.5
Gross fixed capital formation	7.4	5.2	5.0	3.9	3.0	3.3	4.3	4.2
Net exports of goods and services (CZK billions)	-44.3	-60.7	-55.4	-64.7	-22.1	-29.4	-37.0	-39.9
Imports of goods and services	10.9	27.7	18.9	15.9	10.4	-0.4	6.1	4.4
Exports of goods and services	10.7	29.1	22.7	22.6	17.5	6.5	11.3	10.4

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

12 The GDP assessment for 2005 Q1 to Q3 is based on the CZSO's revised estimate which was published simultaneously with the GDP estimate for 2005 Q4.

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

14 For details see *Government demand.*

important. The contribution of gross fixed capital formation to the slowdown in final domestic demand was the lowest, as the slowdown in its growth was negligible in Q4 (down by 0.1 percentage point to 4.2%). However, the evolution of gross capital formation was more favourable at the end of 2005 than in the previous quarter, thanks to inventories.

Consumer demand

In 2005 Q4, annual growth in consumer demand slowed by 0.3 percentage point, reaching 2.6%. The rate of growth of household final consumption expenditure declined, although the increase in households' gross disposable income picked up noticeably above the level recorded in the previous two quarters (to 4.4% in nominal terms and 2.8% in real terms). Households' consumption expenditure thus grew slightly slower than their disposable income in Q4. Contrary to expectations, the gross saving rate increased slightly, by 0.2 percentage point to 7.4%. Households continued to finance their consumption expenditure also from loans drawn from monetary financial institutions. These loans, however, rose more slowly than in the previous quarter and did not contribute to the pick-up in consumption growth (for details see section III.4 *Monetary developments*). According to a CZSO survey, the consumer confidence of households remained high and did not indicate any major changes in households' consumption behaviour.

The slowdown in the growth rate of household consumption was particularly apparent in expenditure on durable consumer goods. On the other hand, growth in expenditure on services increased markedly at the close of the year. However, the trend of faster annual growth in expenditure on durable consumer goods (6.7%) compared to non-durable consumer goods (1.3%) continued, supported mainly by the continuing low growth in prices of many consumer goods. The share of expenditure on durable consumer goods in the total increase in household consumption expenditure was again the highest in Q4.

Gross disposable income remained the main source of financing of the increased household final consumption expenditure in 2005 Q4. Its annual increase was fostered mainly by continuing growth in wages and salaries (of 5.6% year on year), which account for more than 60% of households' disposable income. The contribution from social benefits, which picked up to 7.5% at the close of the year, was also important.[15] By contrast, the growth rate of gross disposable income was adversely affected by income from distributed income of corporations, which fell by 13.6% year on year.

Investment demand

The relatively rapid growth in gross fixed capital formation continued into 2005 Q4, slightly exceeding 4% for the second consecutive quarter (4.2% in Q4). As in the previous three quarters, technological investment[16] had the biggest impact on this annual growth. Investment in machinery and equipment, which is the main component of total investment, recorded the strongest growth (6.2%). Investment in transport equipment grew noticeably slower at the close of 2005 than in the previous quarters (by 2.9%) and its contribution to investment growth was no longer important. By contrast, construction investment showed faster growth of 2.4%, although exclusively in the category of non-residential buildings. Investment in dwellings declined year on year for the third consecutive quarter. In all, the contribution of investment to GDP was 27%.

Chart III.23
Growth in consumer demand slackened slightly in 2005 Q4
(annual percentage changes)

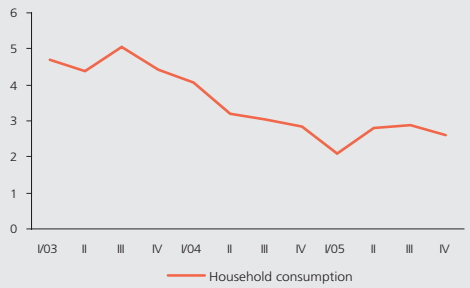


Chart III.24
The gross saving rate again increased somewhat in year-on-year comparison
(annual percentage changes; percentage points)

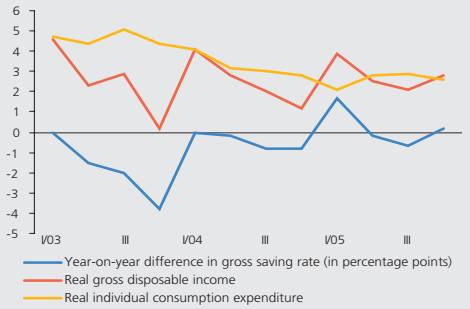
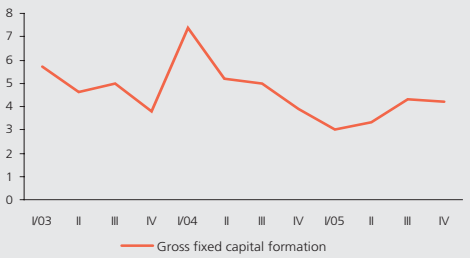


Chart III.25
The relatively buoyant growth in investment demand continued into 2005 Q4
(annual percentage changes)



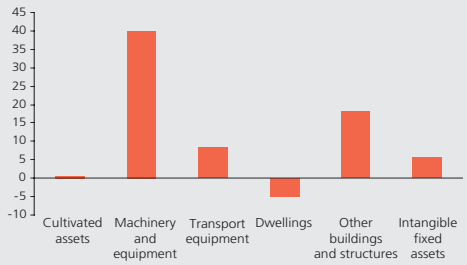
[15] In terms of volume, the growth in social benefits was due mainly to social security payments and pensions, which rose by more than CZK 9 billion.

[16] i.e. investment in other machinery and equipment and transport equipment.

According to partial indicators[17], the overall annual increase in investment in Q4 seemed to be a result of investment activities of non-financial corporations and the government. In the non-financial corporations sector, which accounts for roughly two-thirds of total investment, this was indicated by a pick-up in the growth in acquisition of fixed assets at current prices to 18.9%. In addition to investment in machinery and equipment, construction investment also contributed to this growth at the end of the year. The stronger investment activity in the non-financial corporations sector was driven primarily by the inflow of foreign direct investment, as the largest investment volumes and contributions to their growth in Q4 were again generated in foreign-controlled corporations.

A continuing rise in government investment demand was indicated by a relatively large annual increase in capital expenditure in state and local budgets (8.6% at current prices) and robust growth in construction work in civil engineering, which exceeded 20%. By contrast, investment in dwellings, which fell for the third consecutive quarter (by 3.8% in Q4), suggested that household investment demand did not contribute to the increase in total investment at the close of the year. This was probably due mainly to base effects and to movement of the supply-demand balance on the housing market towards equilibrium. This was also indicated by an annual slowdown in flats under construction (down to 5%) and a decline in housing starts (of 3.8%).

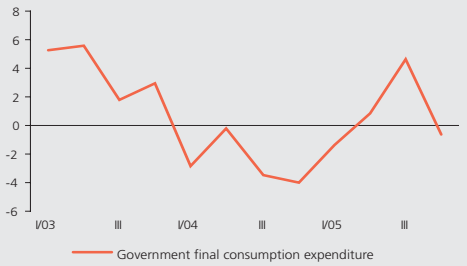
CHART III.26
Rapidly growing investment in machinery and equipment was the biggest contributor to year-on-year investment growth
(annual changes in CZK billions at constant prices; 2005 Q4)



Government demand

General government expenditure on final consumption decreased by 0.6% year on year in real terms in 2005 Q4. This moderate decrease, coming on the back of sizeable year-on-year growth in Q3[18], suggested that government demand had returned to a longer-term downward path. At current prices, final government consumption rose by 3.3% year on year. The assessment of government demand is based on an analysis of the state budget, which represents the most important component of the government sector's performance. In 2005 Q4, the state budget ended in a deficit of CZK 82.1 billion, a deterioration of CZK 29.1 billion compared to the same period a year earlier. This result was due to a substantially larger increase in state budget expenditure (22%) than in budget revenues (13.4%).

CHART III.27
Government final consumption expenditure recorded modest decrease in 2005 Q4
(annual percentage changes)



The relatively fast annual increase in total state budget revenue was fostered by higher tax and non-tax revenues. However, the structural trends were very mixed. As regards corporate income tax, the previous sharp growth trend continued with another extraordinary increase in collection of 36%. Conversely, collection of excise duties fell by almost 14% year on year due to lower collection of excise duties on cigarettes and to base effects. An increase in non-investment subsidies from EU funds and a transfer of funds from the 2004 reserves also contributed to the rise in total state budget revenues.

The pick-up in state budget expenditure growth in 2005 Q4 was a deviation from the trend of relatively low increases in the previous quarters of 2005. The most noticeable reversal in trend occurred at the close of the year in other current expenditure, which increased substantially mainly as a result of a transfer of unspent funds to reserves. However, these expenditure items, just like transfers to regional budgets, social security and health insurance funds and budgetary and subsidised organisations, do not affect government demand in the economy directly. By contrast, government demand is directly influenced by growth in public

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

[18] i.e. a one-off expenditure on the supply of fighter aircraft.

employee wage expenditure, which moderated to 4.2% in nominal terms in Q4 compared to the previous quarter. Overall, then, the state budget performance in 2005 Q4 indicated a negligible contribution of the government sector to the increased demand in the Czech economy.

III.5.2 Net external demand

The annual decrease in negative net exports visible since 2004 Q3 continued into 2005 Q4 (see Chart III.28). The favourable trend in net exports was due mainly to the continuing robust export performance of the Czech economy. The rate of growth of real exports declined slightly in the last quarter of 2005, but remained high at 10.4% year on year. Throughout 2005, imports grew much more slowly than exports. As Chart III.29 shows, the annual growth rate of imports also declined in Q4 compared to the previous quarter (to 4.4%), but this decline was more pronounced than in the case of exports.[19] The lead of the growth rate of exports over imports thus increased to 6 percentage points. In absolute terms, this resulted in an annual reduction in negative net exports of almost CZK 25 billion to CZK 39.9 billion. Under these circumstances, net exports again made a positive contribution to GDP growth, and this contribution was noticeably higher than that of domestic demand.

The favourable net exports were due largely to an improvement in the trade balance. The trade deficit fell by CZK 26.4 billion year on year. This result was aided mainly by rapid growth in goods exports (of 12.6%), supported by several concurrent factors, especially large-scale transfers of production from advanced market economies to the Czech Republic and the continuing launching of export-oriented production facilities in the car industry. A moderation in goods import growth (to 6.1%) and services import growth also contributed to the decline in negative net exports. A closer look at the structure of goods imports reveals that slower growth was recorded in Q4 especially for imports for investment and final consumption. In Q4, investment demand seemed to be satisfied to a greater extent from domestic sources, as indicated by a relatively sharp increase in industrial production of investment products.

While the inflow of foreign capital into manufacturing has already had very favourably effects in improving the trade balance and increasing foreign trade turnover, the inflow of foreign investment into services has not had a major impact on the services balance so far. The deficit on the services balance decreased only modestly in Q4, reaching CZK 2.7 billion.

Chart III.28
The year-on-year decline in the net export deficit continued for the sixth consecutive quarter
(CZK billions; constant prices)

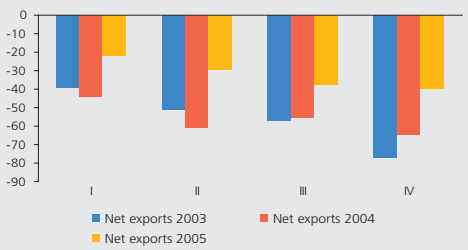
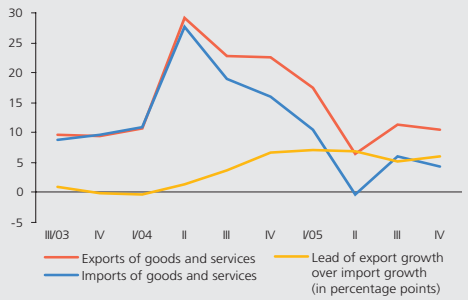


Chart III.29
Exports continued to rise noticeably faster than imports in 2005 Q4
(annual percentage changes; constant prices)

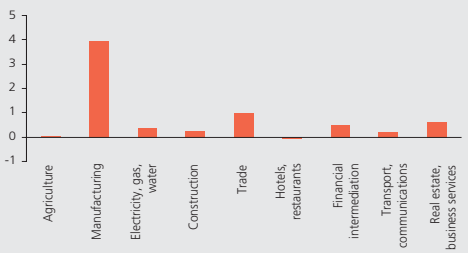


III.5.3 Output

On the supply side of the economy, the buoyant GDP growth in 2005 Q4 and the whole of 2005 was chiefly due to industry and market services. In 2005 Q4, over 50% of the increase in gross value added in the economy was created in manufacturing. The contributions of trade, financial intermediation, energy, real estate activities and business services were also significant. Overall, most sectors contributed to the ongoing economic growth. Only a small number of sectors showed year-on-year declines in gross value added formation.

The fastest value added growth at the close of 2005 was recorded in manufacturing. Value added growth in this sector accelerated gradually from Q2

Chart III.30
Manufacturing and market services were the biggest contributors to GDP growth
(estimated contributions in percentage points; selected branches; 2005 Q4)



[19] While import growth fell by 1.7 percentage points in 2005 Q4, the slowdown in export growth was 0.9 percentage point.

onwards, reaching 16% in Q4. The share of manufacturing in total value added in industry thus increased to more than 85% at the close of 2005. Fast value added growth also continued in the electricity, gas and water supply industry (11.4%), but its contribution to GDP growth was much lower. Only in mining and quarrying did gross value added continue to decline year on year.

The high gross value added growth in industry in Q4 was achieved amid a rise in industrial production of 6.8%[20], supported by a sharp increase in productivity. The rise in employment was modest and did not effect industrial production noticeably. The rapid growth in industrial production in Q4 and the whole of 2005 was connected with the ongoing structural changes in industry. As mentioned in previous Inflation Reports, the structural changes have been due mostly to the inflow of foreign direct investment, developments in demand for individual products and the ability of companies to maintain their market positions in a strongly competitive environment. In 2005, the position of manufacturing strengthened in particular. Within manufacturing, this was especially true of machinery production. The upswing in machinery production was facilitated primarily by the launch of new production facilities in the car industry and fast growth in the manufacture and repair of machinery and equipment, which created conditions for growth in related branches. Manufacture of rubber and plastic products also expanded at a rapid pace. By contrast, production in the textile and leather industry fell in 2005 due to cheap Asian competition.

The ongoing fast growth in industrial production continued to be facilitated to a great extent by the export activities of industrial enterprises at the close of 2005. This was indicated by persisting buoyant annual growth (of 8.7%) in sales revenues from direct exports at constant prices and their share of nearly 50% in total sales in industry. However, the information value of this industry export performance indicator was reduced by ongoing changes in the organisation of trade, which meant that the implementation of exports was partly taken over by trade organisations.

Gross value added in services showed very mixed developments. Trade was again the biggest contributor to GDP growth, with gross value added rising by 6.7% year on year. A relatively important contribution was also recorded in business services and in real estate, where a link to the development of intermediation services in commercial and residential real estate was apparent. Value added again grew fastest in financial intermediation and insurance (by 9.3%), although its contribution to GDP growth was lower than in trade and business services. As regards the other segments of the economy, construction recorded a significant rise in gross value added (of 6%) for the second consecutive quarter. This favourable trend reflected, in particular, the continuing construction of commercial and social centres and civil engineering structures.

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

The financial results of large non-financial corporations for 2005 revealed that profit generation slightly deteriorated compared to the previous year (by 0.3%). However, generation of profit from core activities (operating surplus) increased annually. These results were achieved amid rapid growth in volume indicators and a simultaneous deterioration in the key financial ratios, especially profit-equity, profit-expenses and profit-sales. From the longer-term perspective, however, the values of these ratios can be regarded as being among the best ever.

Chart III.31
The high growth in industrial production was achieved amid rapid productivity growth
(annual percentage changes; constant prices)

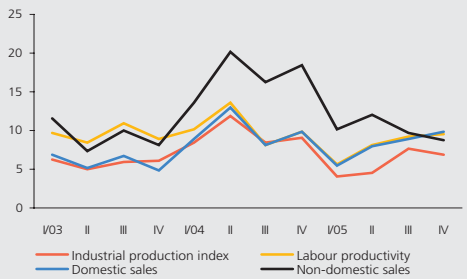


Chart III.32
The industrial producer confidence indicator attained above-average levels by comparison with the average for the past five years
(basic indices)

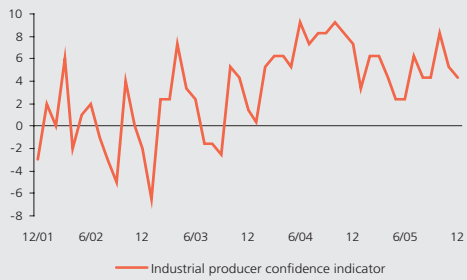


Table III.5
Profit from core activities rose in 2005, but total profit generation decreased slightly year on year
(percentages; percentage points; CZK billions)

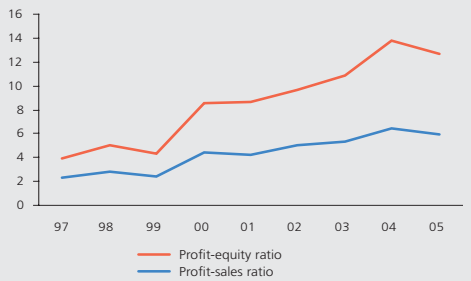
	2004	2005	2005/2004	
	CZK billions		CZK billions	perc.
Output including profit margin	3 212.4	3 495.0	282.6	8.8
Total income	4 547.0	4 933.6	386.6	8.5
Total expenses	4 283.8	4 671.2	387.4	9.0
Cost of sales	2 277.9	2 508.8	230.9	10.1
Depreciation	200.2	204.0	3.8	1.9
Personnel costs	477.9	512.5	34.6	7.2
Book value added	934.5	986.2	51.7	5.5
Net operating surplus	256.4	269.7	13.3	5.2
Pre-tax profit	263.2	262.4	-0.8	-0.3
Net investment a)	227.0	248.0	21.0	9.3
	percentages		perc. points	
Profit-equity ratio	13.8	12.7	-1.1	
Profit-sales ratio	6.4	5.9	-0.5	
Profit-expenses ratio	6.1	5.6	-0.5	
Material cost-output ratio	70.9	71.8	0.9	
Personnel cost-output ratio	14.9	14.7	-0.2	

a) Acquisition of tangible and intangible fixed assets minus incomes from from sales and transfers of tangible and intangible fixed assets

20 At constant prices.

21 Assessment based on figures for non-financial corporations with 100 employees or more.

Chart III.33
The profit-equity ratio remained high in 2005
(percentages)



Throughout 2005, corporations faced some adverse factors on both the cost and output sides. These included, above all, sharply increasing prices of imported energy-producing materials and domestic electricity. Even though the prices of other imported inputs fell year on year, the material cost-output ratio rose, as cost of sales[22] grew faster than output. In absolute terms, cost of sales increased by CZK 231 billion year on year, representing roughly CZK 30.5 billion more than the costs that would correspond to the rise in output of 8.8% in the cost structure of output of 2004. It is reasonable to assume that the rise in cost of sales was due mainly to higher prices of energy inputs. Such additional costs were only partly offset in output by a lower personnel cost-output ratio and slower growth in depreciation. Strong competition on the domestic market, bolstered by the mostly falling import prices of non-energy commodities, limited the possibility for producers to reflect their higher energy costs in prices, as evidenced by the generally moderate producer price inflation and the decline in profit margins. Profit generation in some corporations was also hit by a year-on-year fall in the terms of trade. The impact of these cost pressures on costs across the different sectors was mixed, depending on the energy intensity of production and other opportunities for reducing costs or enhancing productivity.

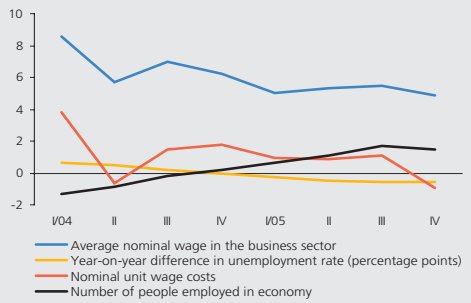
Financial performance was very mixed across the individual sectors and also from the point of view of ownership structure. Higher profit generation was recorded only in the public corporations sector. By contrast, foreign-controlled corporations and domestic private enterprises generated lower profits than in the same period a year earlier (by 3.3% and 3.8% respectively). As regards individual sectors, profits rose fastest in mining of energy-producing materials, manufacture of machinery and equipment and electricity, water and gas supply. Profit generation increased at a slower pace in manufacture of metals and structures, manufacture of transport equipment and in transport, storage and communications. Profit fell year on year in the manufacture of electrical and optical equipment.

Table III.6
The buoyant profit growth in 2005 Q4 was linked chiefly with lower production costs
(percentages; percentage points)

	Organisations, total 2005 Q4 annual perc. changes	Industry 2005 Q4 annual perc. changes
Output including profit margin	8.8	9.5
Total income	8.1	9.0
Total expenses	7.8	9.4
Cost of sales	8.1	10.9
Depreciation	-1.9	2.1
Personnel costs	7.2	6.1
Book value added	10.6	5.4
Net operating surplus	37.4	6.5
Pre-tax profit	15.3	3.5
	percentages	Change in perc. points against 2004 Q4
Profit-equity ratio	3.0	0.1
Profit-sales ratio	5.9	-
Profit-expenses ratio	4.8	0.3
Material cost-output ratio	73.3	-0.4
Personnel cost-output ratio	14.9	-0.2

The financial results for 2005 Q4 suggested a noticeable improvement in profit generation and in profitability ratios compared to the first three quarters of 2005. Total pre-tax profit rose by 15.3% year on year. The increase in gross operating surplus was even stronger. The improvement in profit generation was a result of improved costs in some sectors, while output grew broadly at the same pace as in the previous three quarters of 2005. In particular, significant profit increases were recorded in sectors dominated by foreign-controlled corporations. Profit generation in these corporations was up by an extraordinary 34.5% year on year. Four manufacturing branches (namely manufacture of transport equipment, manufacture of electrical and optical equipment, manufacture of other non-metallic mineral products and manufacture of machinery and equipment) accounted for roughly two-thirds of the overall increase in profit of 15.3%. At the same time, however, profit generation declined in a number of sectors, and three sectors recorded a loss.

Chart III.34
The recovery in employment growth continued into 2005 Q4
(annual percentage changes; percentage points)



III.6 THE LABOUR MARKET

Employment continued to grow in the economy in 2005 Q4. This growth was consistent with the phase of buoyant economic growth, supported mainly by foreign direct investment and related production. Increasing employment in the secondary and tertiary sectors helped reduce unemployment. However, the cyclical component of registered unemployment did not decline to an extent corresponding to employment growth at the end of 2005. The number of vacancies registered by labour offices was also inconsistent with demand for labour. These facts suggested

[22] Cost of sales accounted for about 71% of the value of output.

that the growing labour demand had been partly generated outside the labour office register. A larger decrease in unemployment was prevented by the professional and skills structure of the unemployed, reflected in persisting high long-term unemployment. The fast economic growth accompanied by the recovery in employment growth had no effect on wage growth. Nominal and real average wages rose more slowly in Q4, and the personnel cost-GDP ratio decreased. Under such conditions, no inflationary pressures were generated in Q4, owing to the unbalanced developments in the relationship between wage and productivity variables.

III.6.1 Employment and unemployment

The latest CZSO data on employment in 2005 Q4 confirmed a continuing rise in the number of people employed in the economy, amid buoyant economic growth. Annual growth in the number of employed reached 1.5%, being only slightly lower than in the previous quarter. However, the structural trends in employment remained very mixed. Chart III.35 shows that total growth in employment in the economy was again only due to growing numbers of employees. They increased by 2.3% year on year in Q4[23], while the number of entrepreneurs continued to decline (by 2.6%). The underlying reasons for this phenomenon have been described in detail in previous issues of the Inflation Report. In 2005, it was chiefly due to an improving supply of steady employment opportunities and strong competition from expanding large retail units, as, according to the CZSO, the largest decreases in entrepreneurs were mainly recorded in the retail trade.

Employment increased in the secondary and tertiary sectors, which accounted for much of the buoyant economic growth. In the secondary sector, employment grew mainly in manufacturing, owing to foreign direct investment and related production. Although the employment growth rate in the construction industry recorded a decline in Q4, the sector employed 21,700 persons more on average in 2005 than in 2004. As regards market services, employment grew in particular in real estate and business activities, while public services mainly saw growth in education and in public administration and defence.[24] At the end of 2005, 56.5% of the employed worked in services and nearly 40% in the secondary sector. The rise in employment was not across the board in nature in 2005 Q4; some sectors conversely saw decreasing employment as a result of changing demand and strong competition exerting downward pressures on costs (in agriculture etc.).

One of the indicators of the changing situation on the labour market is the creation of vacancies, which should be reflected – with a lag – in the data on employment and unemployment. As in previous quarters, the rising employment in a number of branches at the end of 2005 was not accompanied by greater creation of vacancies registered by labour offices. Growth in vacancies had been declining for several months and was less than 1,000 in December, while the rise in employment was around 70,000 people. This suggests that the data on vacancies in this period were not a reliable indicator of labour demand and that the growing labour demand was partly generated outside the labour office register. According to the latest data for March 2006, the number of vacancies showed sizable annual growth (of 16,700 in total), but it was seemingly largely due to new penalties imposed on employers who fail to report vacancies to labour offices.[25]

Chart III.35
Employment continued rising only in the employees category
(annual percentage changes)

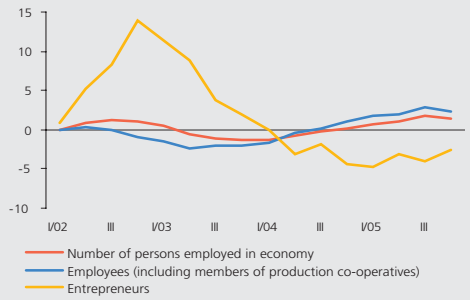


Chart III.36
Demand for labour increased in the secondary and tertiary sectors
(annual percentage changes; source: LFS)

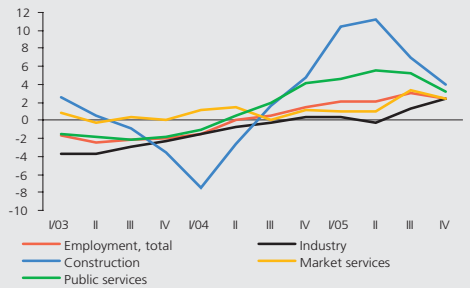
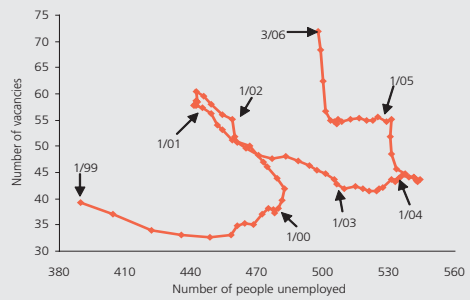


Chart III.37
The higher growth in vacancies at the start of 2006 was chiefly due to new administrative measures
(seasonally adjusted numbers in thousands)

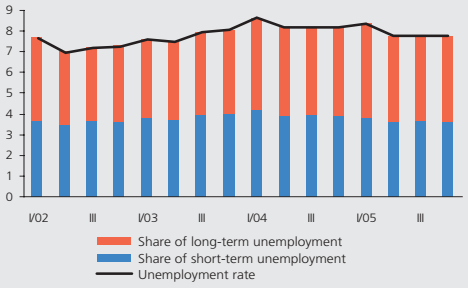


[23] Including members of production co-operatives.

[24] Market services = wholesale and retail trade, hotels and restaurants, transport, financial intermediation, real estate and business activities. Public (non-market) services = public administration and defence, education, health and other public services.

[25] A similar change occurred at the end of 2004, when the number of reported vacancies increased following the coming into force of the new Employment Act in October 2004.

Chart III.38
High structural unemployment prevented any larger fall in unemployment
(percentages; source: LFS)



Although unemployment recorded a year-on-year decline in Q4 (of 28,000 people), this decline was lower than in the previous quarter. This trend was confirmed by the latest figures for 2006 Q1, according to which the number of people unemployed decreased by 27,700. At the same time, a sizeable inconsistency was observed between the employment and unemployment trends,[26] again suggesting that the main source of the increasing employment in the economy was labour not registered at labour offices. According to the MLSA data, one of the major sources of such labour was the increasing number of foreign workers, who are mainly employed in particular sectors of the economy. At 7.8%, the general unemployment rate did not record any further year-on-year fall in 2005 Q4. The seasonally adjusted registered unemployment rate declined at a modest pace, although this fall was mainly due to a higher number of unemployed persons excluded from the labour office register as a result of penalties.[27]

The continuing cyclical improvement in the situation on the labour market has not yet led to a substantial narrowing of the regional, skills and professional gaps between the supply of, and demand for, labour. The share of long-term unemployed (more than one year) in the total number of unemployed persons remained above 50% and showed an upward trend.

III.6.2 Wages and productivity

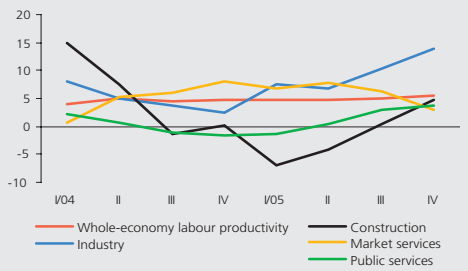
Table III.7
Average nominal wage growth remained subdued in 2005 Q4
(annual percentage changes)

	2004 Q1	2004 Q2	2004 Q3	2004 Q4	2004	2005 Q1	2005 Q2	2005 Q3	2005 Q4	2005
Average wage in monitored organisations										
nominal	8.8	4.2	7.3	6.3	6.6	5.8	5.3	6.2	4.8	5.5
real	6.3	1.7	4.1	3.1	3.7	4.1	3.7	4.2	2.3	3.6
Average wage in business sector										
nominal	8.6	5.7	7.0	6.2	6.9	5.0	5.3	5.5	4.9	5.2
real	6.1	3.1	3.7	3.0	3.9	3.3	3.7	3.5	2.4	3.2
Average wage in non-business sector										
nominal	9.6	-0.5	8.3	6.4	5.7	8.9	5.5	8.6	4.5	6.7
real	7.1	-3.0	4.9	3.2	2.8	7.1	3.9	6.6	2.1	4.7
Whole-economy labour productivity	4.1	5.1	4.4	4.8	4.6	4.6	4.8	5.1	5.6	5.0
Nominal unit wage costs	3.8	-0.7	1.5	1.7	1.5	1.0	0.9	1.1	-0.9	0.5

The downward trend in average nominal wage growth in the economy, observed with slight fluctuations since 2004, continued into 2005 Q4. At the end of the year, annual wage growth slowed to one of the lowest levels seen in 2004–2005 and amounted to 4.8%. Real average monthly wage growth declined to 2.3%. Overall, average nominal wages recorded slower growth in 2005 than in the previous year, while real wages grew at roughly the same rate in 2005 as in 2004, owing to lower annual inflation.

The slower overall growth in average wages in 2005 was linked with wages in the business sector, which are being affected by the competitive environment constraining potential growth in prices. In Q4, average nominal wage growth in this sector slowed to 4.9%; average hourly earnings growth was higher, reaching 6.6%.[28] The structural developments in wages were rather mixed. The differences in the growth rates of wages across sectors were due to several factors, in particular differences in productivity growth, the impact of external cost pressures stemming from growing energy prices and the level of competition in individual branches and in the other options available for reducing wage cost-output ratios (for example by employing people with lower wage demands). In Q4, the fastest growing average wages were recorded in the electricity, gas and water supply industry (8%), accompanied by a decline in the number of employees, and in services in the area of real estate and other business activities (8.2%). Manufacturing saw subdued growth in average wages (4.8%) amid rapid growth in productivity.

Chart III.39
The upswing in whole-economy productivity growth in 2005 Q4 was mostly due to industry
(annual percentage changes)



Wages in the non-business sector showed a more fluctuating trend in the course of 2005. In contrast to the business sector, they rose faster than in the previous year

[26] Although the number of employed persons increased by 71,000 year on year, the number of unemployed persons declined by a mere 28,000.

[27] Persons who refuse to co-operate with labour offices, accept a job offer, etc. are excluded from the register of unemployed persons.

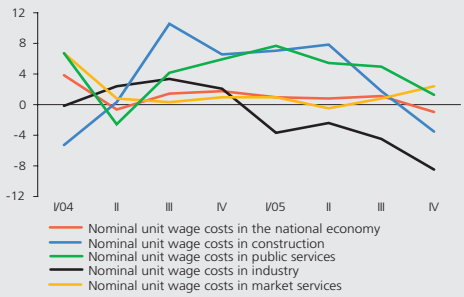
[28] The calculation of hourly wages is based on a wider set of corporations than the calculation of wages provided by the CZSO. Small enterprises with 10–19 employees are also included.

(to 6.7%). This was due to a pay adjustment in certain professions[29] at the start of 2005. The marked decline in annual average wage growth in Q4 (to 4.5%) was due to the abolition of the "thirteenth" and "fourteenth" paycheques as from 2005.

Annual growth in whole-economy productivity has been accelerating since 2005 Q2, reaching 5.6% at the end of the year. This marked increase from the perspective of previous years was largely due to increasing output of the economy; the impact of the moderate slowdown in employment growth was less significant. Rapid productivity growth continued particularly in industry, where it reached 14% in Q4.[30] This extraordinary growth was largely associated with the development of production supported by foreign direct investment and with related, mainly export-oriented production. Faster productivity growth, of around 4%, was recorded by construction and public services, whereas slower productivity growth was only registered by market services.

The faster overall growth in productivity in conjunction with the slower growth in average wages compared to the previous quarter fostered a reduction in the personnel cost-output ratio in Q4. Under these circumstances, nominal unit wage costs, which are an indicator of potential inflationary pressures, recorded a year-on-year fall (of 0.9%), following five quarters of growth. A particularly large fall in the personnel cost-output ratio was observed in industry (see Chart III.40), which is the most exposed to the external competitive environment. As regards the other monitored sectors, nominal unit wage costs increased only in market services.

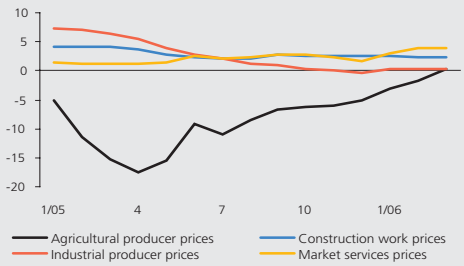
CHART III.40
Nominal unit wage costs decreased overall in 2005 Q4, with only market services recording increased growth
(annual percentage changes)



III.7 IMPORT PRICES AND PRODUCER PRICES

Faster growth in prices of energy-producing materials at the end of 2005 and at the start of 2006 Q1 indicated continuing external cost pressures. Import prices of mineral fuels saw a sharp annual rise, passing through significantly into producer prices at the initial stages of the product vertical. Commodity prices in other import categories mostly decreased in year-on-year terms, creating conditions for low inflation or a decline in domestic prices. These facts contributed to the overall modest annual rise in industrial producer prices in 2006 Q1, which was mainly due to higher oil prices. Fast growth in producer prices was recorded in only two sectors – primary oil processing and power generation, but their pass-through into prices in other sectors has been imperceptible so far. Agricultural producer prices recorded a slight upturn at the end of Q1 on the back of a rather long period of an annual decline. Prices of construction work saw slightly slower growth, while prices of market services for the production sector picked up noticeably.

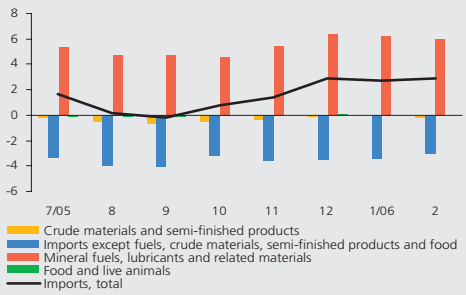
CHART III.41
Producer prices showed mixed trends, with market services prices and agricultural producer prices recording major changes
(annual percentage changes)



III.7.1 Import prices

At the start of 2006, import prices, which are one of the key factors of domestic inflation in the highly open Czech economy, confirmed a continuing upturn in prices of imported commodities. Growth in import prices increased noticeably to 2.9% at the end of 2005 and remained around this level in the first two months of 2006.

CHART III.42
Import prices rose further at the start of 2006 as a result of rapidly rising prices of energy-producing materials
(annual percentage changes; contributions in percentage points)



29 Salaries in the police service, the prison service, fire brigades and the customs administration increased in January 2005, and wage scales in the health sector increased in September 2005.

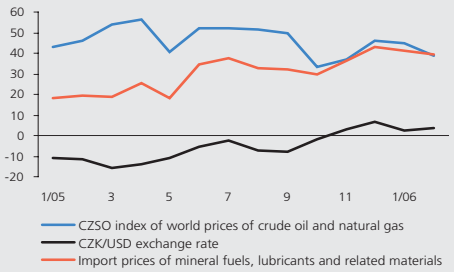
30 Value added per employed person under national accounts methodology. According to the monthly CZSO data, labour productivity is increasing above all in the manufacture of transport equipment and in the manufacture and repair of machinery and equipment (data based on sales at constant prices).

The upturn in import price inflation in the second half of 2005 and at the start of 2006, coming on the back of a rather long period of an annual decline, was chiefly associated with persisting very rapid growth in prices of energy-producing materials on world markets. Annual growth in world prices of oil and natural gas fluctuated around 45% in December and January and was the main cause of high growth in the CZSO world price index (41% in January). Although growth in oil prices recorded a marked slowdown in February, it remained high, exceeding 30%. Natural gas price growth, which usually follows changes in oil prices with a lag, has been noticeably higher than oil price growth since October, reaching 44.8% on a year earlier according to the latest figures for February.

Chart III.43

The weakening koruna-dollar exchange rate ceased to dampen the impacts of world prices of energy-producing materials on domestic prices in November 2005

(annual percentage changes)



Also important from the point of view of domestic inflation was the fact that the koruna-dollar exchange rate had been weakening since November 2005 and thus, unlike in previous quarters, failed to reduce the impact of the high prices of energy-producing materials on import prices. Under these circumstances, mineral fuels remained the only category within the import price index[31] at the beginning of 2006 to show rapid annual price growth. Their annual growth picked up to 43.1% in December and remained at around 40% in January and February 2006 as well.

Import prices of mineral raw materials excluding fuels have been showing only modest growth or a slight annual decline since May of last year (a decline of 0.1% in January). Their annual decline deepened significantly in February, amounting to 3.2%. Underlying these price changes have been mostly falling year-on-year prices of an important component of imports of non-energy-producing materials – iron ore, as prices of most other raw materials excluding fuels have recorded marked annual growth. Prices of imported food imports recorded a slight increase in February (of 0.6%). An annual decline in prices prevailed in the other import categories at the start of 2006, although prices here declined to a lesser extent overall than at the end of 2005.

Table III.8

Prices fell in the majority of import categories; only prices of energy-producing materials rose quickly

(annual percentage changes)

	9/05	10/05	11/05	12/05	1/06	2/06
Imports, total	-0.2	0.8	1.4	2.9	2.7	2.9
Food and live animals	-2.4	-0.8	0.2	1.5	0.0	0.6
Beverages and tobacco	-1.6	-3.7	-4.0	-4.5	-3.6	-0.1
Crude materials except fuels	-2.1	-0.2	0.2	1.4	-0.1	-3.2
Mineral fuels and related products	31.9	30.0	36.5	43.1	41.3	39.6
Animal and vegetable oils	-14.2	-12.8	-14.7	-10.8	-7.6	-8.0
Chemicals and related products	-3.6	-0.8	-2.5	-2.0	-1.9	-2.5
Manufactured goods classified by material	-3.2	-2.5	-1.9	-0.6	-0.1	-0.2
Machinery and transport equipment	-4.2	-2.5	-2.4	-1.5	-1.3	-0.9
Miscellaneous manufactured articles	-8.9	-8.2	-8.2	-7.8	-8.4	-6.6

Import prices in import categories with products with a higher degree of processing continued to show an annual decline. At the start of 2006, they were again most affected by machinery and transport equipment, the highest-weight category. Their year-on-year fall eased further (to -0.9%) according to the latest figures for February. The underlying reasons remain the same – faster growth in industrial producer prices in major trading partner countries (particularly Germany) amid a gradual decrease in the year-on-year appreciation of the koruna-euro exchange rate compared to previous months.[32] A similar trend was recorded for some other higher-value-added products, in particular manufactured goods, although import prices of imported chemicals and miscellaneous manufactured articles declined more significantly than at the end of 2005.

The mixed developments in import prices across the individual categories of the CZSO's import price index implied different impacts on the individual producer and consumer price categories. Overall, however, import prices mostly decreased, continuing to create conditions for slower growth or a decline in domestic prices. Continuing fast growth in import prices of energy-producing materials (oil and natural gas) was the only potential source of major external cost pressures on domestic producer and consumer inflation.

31 The import price index using the SITC classification.

32 The koruna-euro exchange rate appreciated by 6% in 2005 Q3, 5.5% in 2005 Q4 and 4.7% in 2006 Q1 year on year.

III.7.2 Producer prices

Industrial producer prices

The slowdown in annual industrial producer price inflation during 2005, which culminated in a slight annual decline in prices in December, was replaced by an upswing in price growth at the beginning of 2006. However, according to the latest figures for March, this growth was only moderate (0.3%) and was mainly due to faster growth in oil prices on world markets at the end of 2005 and the start of 2006.

As in previous quarters, primary oil-product processing industries, for which oil is a very important cost input, responded most strongly to the changes in world oil prices. Chart III.44 shows that the marked upswing in producer price inflation in this sector – from 4.9% in December to 16.5% in February – was virtually the sole factor underlying the faster growth in industrial producer prices in this period. Inflation in this sector moderated somewhat in March, reaching 14.3%.

Relatively fast price growth continued in non-manufacturing industries in 2006 Q1, although their overall contribution to the faster growth in producer prices was only slightly higher than at the end of 2005. A pick-up in inflation was recorded for the electricity, gas and water supply industry, although this change was not significant (from 7.2% in December to 7.5% in March). The continuing high inflation in this sector continued to be caused primarily by rising prices of electricity for the corporate sector. Following the unwinding of the step increase in coal prices in October 2004, inflation in mining and quarrying was moderate, reaching 1.3% in March.

Producer prices in food industry again recorded an annual decline in 2006 Q1. The decline moderated in March by 0.7 percentage points compared to December 2005, amounting to 2.8%. Underlying this was a slowing annual fall in prices of cereals. However, the annual decline in prices in primary metal processing deepened further at the beginning of 2006 (from 5.5% in December to 6.1% in March) owing to the evolution of prices of imported metal semi-manufactures. Prices in most other manufacturing industries continued to decline or to increase slightly.

Overall, industrial producer prices showed very mixed developments at the beginning of 2006. Fast price growth was only recorded by two sectors – the oil-processing sector at the beginning of the production chain and the power generation sector. The slightly rising or declining prices in other sectors suggest that the transmission of the higher costs of energy sources and oil products into producer prices was not significant in the majority of sectors. This was due to several factors, in particular the energy inputs and oil products required by individual sectors, the relatively strong productivity growth in the majority of sectors and other options available for cutting costs (for example by employing people with lower wage demands), amid a strongly competitive environment not creating a sufficient room for price growth.

Agricultural producer prices

Agricultural producer prices recorded an annual decline at the beginning of 2006 Q1; this decline was, however, relatively modest compared to 2005, reaching 1.7% in February. In March, they increased by 0.3% year on year. Chart III.46 shows that this change was mainly associated with crop prices, which for the first time in a long time started to show annual growth in February. This growth reached 11% in March. By contrast, the annual decline in livestock product prices increased further, to 4.2% in March.

Chart III.44
The structure of industrial producer price inflation was virtually unchanged at the start of 2006
(annual percentage changes; contributions in percentage points)

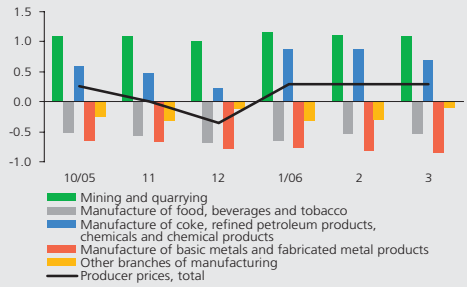


Chart III.45
Producer prices recorded rapid growth only in branches involved in primary processing of oil products and power generation
(annual percentage changes)

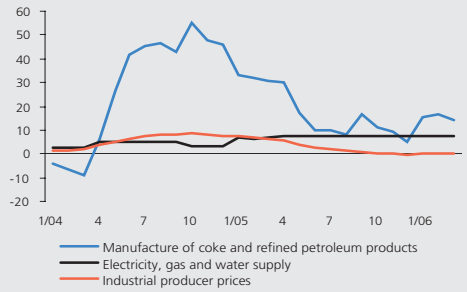
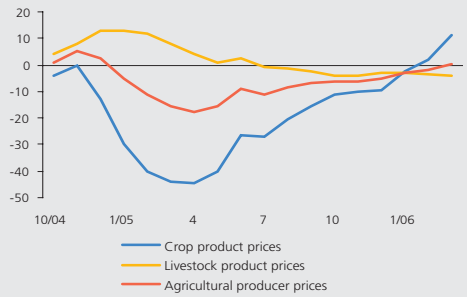


Chart III.46
The sharp decline in crop production prices turned into annual growth in 2006 Q1
(annual percentage changes)



The relatively fast decrease in the annual decline in crop product prices since April of the previous year and their subsequent rise was a result of changes in prices of several products. The renewed growth was fostered by the rather volatile prices of vegetables, which picked up from 34.3% in December to 70.5% in March. Prices of potatoes also rose sharply to 40.5% in March, following 20 months of decline. The slackening of the annual decline in prices of cereals was also significant (to 0.7% in March). However, the past elimination of the surplus from previous harvests on the agricultural market had yet to result in renewed growth in prices of cereals. This was also probably due to the relatively high annual appreciation of the koruna-euro exchange rate, which, in the case of cereals, reduced the koruna level of EU intervention prices, thus exerting downward pressures on domestic prices. However, unlike in previous periods, domestic prices of cereals were slightly above EU intervention prices at the beginning of 2006.

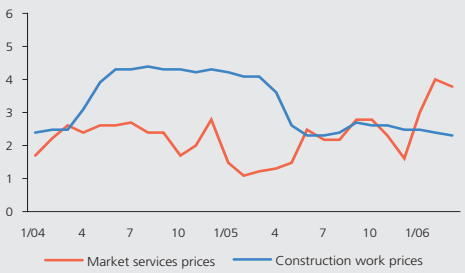
The persisting annual decline in livestock product prices at the beginning of 2006 was still largely due to base effects, reflecting the temporary improvement in the conditions for exporting livestock products after the Czech Republic's accession to the EU. All the main categories of livestock production except cattle contributed to this development. A particularly marked decline in prices was observed for poultry at the beginning of 2006; this was linked with a decline in prices on markets in EU countries. The 4.7% annual appreciation of the koruna-euro exchange rate in 2006 Q1 also helped to keep livestock product prices lower than in the same period a year earlier.

Other producer prices

Prices in construction showed no major changes at the beginning of 2006 compared to the second half of 2005. Their year-on-year growth decreased only slightly compared to December 2005 (by 0.2 percentage point to 2.3% in March). The main factor underlying the slight slowdown in construction price inflation was considerably slower growth in prices of materials and products consumed in the construction industry (to 0.1% in March), which was related, in turn, to a decline in prices of imported semi-manufactures and certain miscellaneous manufactured articles used in the construction industry.

By contrast, growth in prices of market services for the production sector increased at the beginning of 2006 (from 1.6% in December to 3.8% in March). This change was mostly due to a marked pick-up in year-on-year growth in market prices of real estate activities and other business services (from 0.9% in December to 4.4% in March), in particular advertising, architectural and engineering services. Prices also rose in postal and telecommunication services, owing to an increase in prices of telephone services, and financial intermediation. Inflation slowed in other market services categories.

CHART III.47
Market services price inflation in the production sector increased sharply at the start of 2006
(annual percentage changes)



IV.1 EXTERNAL ASSUMPTIONS OF THE FORECAST

Expectations regarding the external environment are one of the key assumptions of the forecast. For this purpose, the CNB has as usual drawn mainly on the publication Consensus Forecasts, which brings together the forecasts of a range of foreign analytical teams. The current reference scenario is based on the April data from this publication and on market information effective on the survey date.[33] Based on this information, the assessment of the external effects on the Czech economy has shifted slightly in the inflationary direction.

Compared to the January forecast, the new reference scenario incorporates some modifications connected with an expected VAT rate change in Germany as from the beginning of 2007. According to the new outlook, consumer price inflation in Germany is expected to rise from 1.6% this year to 2.3% in 2007, mainly because of VAT changes. Given its cause, however, the higher inflation should not create upward pressure on import prices in the Czech Republic. Nonetheless, expected annual producer price inflation in Germany has also increased, to 3.8% in 2006 and 1.9% in 2007. The 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 economies, has also been revised in connection with the future change in VAT. The expected positive impact of the tax change on consumption in 2006 as a result of forward buying by consumers will pass through into a slightly higher than previously expected growth rate of German GDP in 2006, at 1.7%, whereas a sizeable fall in consumption and a corresponding slowdown in economic growth to 1.0% are expected in 2007.

Table IV.1
External demand growth will remain sluggish in 2006 and 2007

	II/06	III/06	IV/06	I/07	II/07	III/07	IV/07
Ural crude oil prices (USD/barrel)	59.2	54.5	53.2	52.5	52.4	52.4	52.4
ARA petrol prices (USD/t)	411.8	436.7	423.6	434.1	510.8	646.2	543.1
GDP in Germany (annual, in per cent)	1.4	1.6	2.1	1.3	1.0	0.8	0.9
Producer price inflation in Germany (annual, in per cent)	4.6	3.1	2.0	0.9	1.5	2.5	2.7
Consumer price inflation in Germany (annual, in per cent)	1.7	1.4	1.3	2.9	2.4	2.0	1.9
Nominal USD/EUR exchange rate	1.217	1.226	1.236	1.250	1.265	1.269	1.271
1Y EURIBOR	3.2	3.4	3.5	3.6	3.7	3.7	3.8

The outlook for oil prices has been revised upwards due to their persisting high level. The average price of Ural crude oil in 2006 Q1 was USD 57.8 a barrel, 9% higher than assumed in the January forecast. The new outlook expects prices to remain high in the first half of this year and then fall gradually, stabilising around USD 53 a barrel. After increasing in the coming quarter, the dollar price of petrol[34] should fall up to the end of the year. However, it is forecasted to record another relatively sizeable upswing in 2007, to USD 670 a tonne.

Since the previous forecast, the expected 1Y interest rates in the euro area have shifted further upwards over the entire forecast horizon. The reference scenario thus expects the 1Y EURIBOR rate to rise gradually to 3.8% at the close of 2007. The expected dollar-euro exchange rate reflects the slight weakening of the dollar in 2006 Q1 and the unchanged assumption that it will continue to depreciate moderately.

IV.2 INTERNAL ASSUMPTIONS OF THE FORECAST

In addition to assumptions regarding the external environment, assumptions about the effects of domestic fiscal policy are an important exogenous input to the forecast. On the basis of new information contained in the spring notifications of the European Commission, the expectations of future public budget performance were partly reassessed. The estimate of the public finance deficit under ESA95 methodology was increased for both years, to 2.4% of GDP in 2006 and 3% of GDP in 2007. In this context, the estimated effect of fiscal policy on economic activity was

[33] In order to determine the reference trajectories of some economic variables which are inputs to the forecast but are not included in the Consensus Forecasts publication, the expected evolution of these variables is derived from market contracts as of the survey date of the reference publication. These variables are the outlook for 1Y EURIBOR rates and the outlook for dollar prices of petrol.

[34] As of the April forecast, the expected dollar prices of petrol form part of the external assumptions. These prices are derived from swap contracts on the ARA (Amsterdam-Rotterdam-Antwerp) exchanges.

revised. The forecast thus assumes a slightly higher positive contribution to economic growth than predicted in January for both years. At the forecast horizon, no sizeable additional fiscal impulse is expected from the inflow of money from EU funds.

Another factor determining the message of the forecast consists of assumptions regarding the equilibrium values of key macroeconomic variables, especially real interest rates and the real exchange rate, and regarding the non-accelerating inflation level of output. These variables are used to derive the current position of the economy in the business cycle and the current settings of the monetary conditions. The evolution of the equilibrium values at the same time provides the framework for the fundamental orientation of the forecast. 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.

The estimated equilibrium paths of real interest rates and the real exchange rate were changed in the January forecast. The current forecast preserves the direction of the original shift, but slightly modifies the estimate on the basis of additional analyses without any significant impact on the message of the forecast. The modified estimate of the annual rate of equilibrium real appreciation at present as well as over the entire forecast horizon is around 3.5%, with a moderate gradually declining tendency. The equilibrium annual real money market interest rate is slightly below 1% and is also gradually declining at the forecast horizon. In the context of the high observed GDP growth rates and the continuing absence of demand pressures, the estimated growth rate of the non-accelerating inflation level of output has been revised upwards to around 5.5% since the last forecast. This rate declines gradually at the forecast horizon, but still remains above the assumed long-term sustainable level of 4.5%.

The buoyant economic activity led to a rapid closing of the output gap in previous quarters. The economy is currently slightly above the non-accelerating inflation level of output. At the beginning of 2006, GDP growth is still being driven by net exports, although the lead of export growth over import growth is decreasing and investment demand is also recovering. In 2006 Q1, household consumption continued to show subdued growth at the 2005 level. The forecast is for a moderate recovery in annual government consumption growth.

In 2006 Q1, consumer prices rose in line with the forecast. They continued to be affected by contrary movements in energy prices and other cost factors, while the exchange rate of the koruna had a strong anti-inflationary effect. Import prices excluding energy prices continued to decline year on year. With the exception of March, this was also true of agricultural producer prices. The position of the economy in the business cycle had a broadly neutral effect on inflation.

The settings of the real monetary conditions in 2006 Q1, which affect the course of the business cycle in the coming quarters, can be described overall as slightly tight, largely as a result of a tightening of the exchange rate component at the beginning of 2006. The effect of the interest rate component has been viewed as neutral to slightly easy for several quarters.

IV.3 THE MESSAGE OF THE FORECAST

The current forecast partially changes the view of the projected evolution of economic growth, the structure of that growth and the output gap in 2006 and 2007. This change is primarily due to the unexpectedly fast growth in economic activity in recent quarters, which has led to an increase in the estimated path of the non-accelerating

inflation level of output and partially also to a revision of the initial output gap from slightly negative to slightly positive. The forecast has been further affected by changes in the external economic outlook and the outlook for domestic fiscal policy and changes in the real monetary conditions. In the coming period, the high GDP growth at the end of 2005 and the slightly easier fiscal policy will be counteracted by a tighter exchange rate component of the monetary conditions and still weak external demand. They will foster a halt to any further opening of the output gap into positive figures. In the second half of the forecast horizon, economic growth will be boosted by an easy fiscal policy and a gradual easing of the real exchange rate due to broad stability of the nominal exchange rate and a rise in external inflation against a background of real equilibrium appreciation. The growth of the economy in this period will, however, continue to be subdued by weak external demand. The output gap will thus remain close to neutral figures at the forecast horizon. This is consistent with an average real GDP growth rate of 6.1% in 2006 and 5.4% in 2007.

Household consumption will be positively influenced by the cyclical developments on the labour market in the following quarters. Wages and salaries in the business sector will gradually increase, despite the dampening effects of employment of people with lower wage demands and slower growth in employment towards the end of the forecast period. Sizeable growth in transfers in 2007, stemming mainly from a rise in family allowance, will foster a further rise in disposable income. In real terms, however, disposable income growth will be dampened by higher inflation. The lagged effect of the easy interest rate component of the monetary conditions will be reflected in a decline in the gross saving rate to a level close to 7%, thus allowing real consumer spending to increase by 2.8% in 2006 and 2.9% in 2007. The forecast for government consumption saw no major revisions connected with the new outlook for public budgets. In real terms, government consumption will rise at a rate of 1% in 2006 and decline by 0.4% in 2007.

Growth in gross fixed capital formation will recover. The increase in investment activity in the private sector will be bolstered by a further inflow of foreign direct investment. A gradual tightening of real interest rates will slow the growth rate somewhat towards the end of the forecast period. A positive contribution from public sector capital expenditure is also expected in both years. Gross fixed capital formation will increase by 6.8% in 2006 and 6.4% in 2007.

The growth trend in export performance, connected with the inflow of foreign direct investment and related changes on the supply side of the economy, will continue into 2006 and 2007, although to a lesser extent than in 2005. Modest growth in external demand will help maintain real export growth just above 10% in 2006, despite a tighter real exchange rate. Conversely, a gradual easing of the exchange rate will not fully offset a cooling of the external recovery in 2007 and real export growth will slow slightly to 9.5%. Real import growth will increase owing to faster growth in domestic demand. The increase will, however, be dampened by a downward trend in the import intensity of aggregate demand. Although the growth rates of 8.1% and 8.9% in 2006 and 2007 respectively will come close to those of real exports, the net export deficit at constant prices will continue to decrease.

Mainly for 2006, the forecast predicts pressures for a slight correction of the previous appreciation of the exchange rate, stemming from the negative interest rate differential vis-à-vis foreign interest rates amid higher domestic inflation. At the end of the forecast period, these pressures will be outweighed by the long-term equilibrium appreciation of the real exchange rate and the trend towards modest appreciation of the koruna will be renewed.

The predicted inflation path is determined by the combined demand-pull pressures resulting from real economic activity, imported inflation and other cost factors. The inflation forecasts for 2006 and 2007 have both been revised downwards slightly.

Chart IV.1
The output gap closed at the end of 2005 and the start of 2006
(annual percentage changes; percentages of GDP; seasonally adjusted)

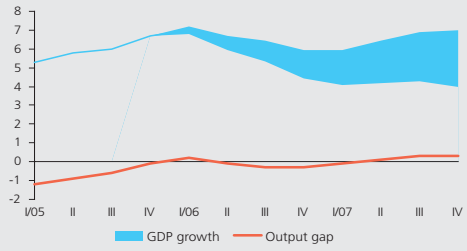


Table IV.2
Unemployment will fall only slightly
(annual percentage changes)

	2006	2007
Real disposable income of households	2.0	3.0
Unemployment rate (in per cent)	9.2	9.0
Labour productivity	4.7	5.0
Current account deficit (ratio to GDP in per cent)	-2.2	-1.5
M2	7.4	6.9

Table IV.3
Economic growth will be driven by net exports and investment
(annual percentage changes)

	2006	2007
Gross domestic product	6.1	5.4
Household consumption	2.8	2.9
Government consumption	1.0	-0.4
Gross fixed capital formation	6.8	6.4
Imports of goods and services	8.1	8.9
Exports of goods and services	10.2	9.5
Net exports of goods and services (in CZK bn, at constant prices)	-99.1	-94.7

Table IV.4
Growth of inflation will be driven primarily by regulated prices
(annual percentage changes)

	II/06	III/06	IV/06	I/07	II/07	III/07	IV/07
Annual consumer price inflation	2.7	2.7	2.4	2.8	3.0	3.8	3.9
Breakdown into contributions:							
regulated prices	11.1	9.4	5.5	4.4	3.9	3.8	3.9
indirect taxes (contributions in p.p.)	0.4	0.6	0.8	0.5	0.6	1.1	0.9
food prices, excluding changes to indirect taxes	-1.5	-1.1	-0.3	1.5	2.2	2.4	2.7
fuel prices, excluding changes to indirect taxes	7.5	-4.7	-4.7	6.1	1.0	2.7	2.5
adjusted inflation excluding fuels, excluding changes to indirect taxes	0.4	1.0	1.3	1.5	1.9	2.3	2.7

Chart IV.2
The inflation forecast is above the point inflation target in the second half of the monetary policy horizon
(annual percentage changes in CPI)

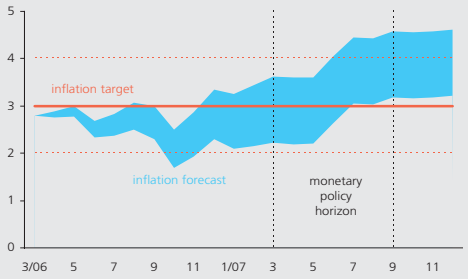


Chart IV.3
Excluding the first-round impacts of indirect taxes, inflation is below the point inflation target at the monetary policy horizon
(annual percentage changes)

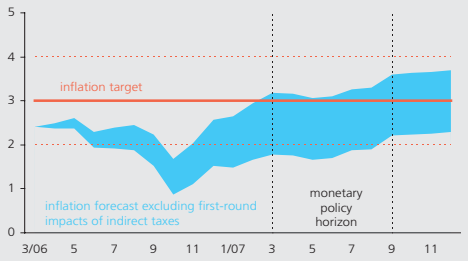


Table IV.5
The inflation expectations of the financial markets and corporations were below the CNB's target
(percentages)

	12/04	12/05	1/06	2/06	3/06
Consumer price index					
1Y horizon:					
Financial market	2.8	2.6	2.5	2.5	2.5
Corporations	3.2	2.8			2.7
Households	1.5	4.6			4.1
3Y horizon:					
Financial market	2.8	2.5	2.4	2.4	2.4
Corporations	2.7	2.9			2.9
Households	1.8	5.2			6.2
1Y PRIBOR					
1Y horizon:					
Financial market	3.4	2.8	2.7	2.6	2.8

As the January forecast for the first quarter of this year was fulfilled, this is mainly due to the anti-inflationary effect of the appreciation of the exchange rate and the downscaling of the import price and food price forecasts, which will not be outweighed by higher fuel price growth and a slightly higher inflationary effect of the real economy compared to the previous forecast. Inflation will be slightly below 3% for the remainder of 2006. At the monetary policy horizon, it initially lies very close to the point inflation target but then increases above it.

In the coming two years, consumer price inflation will be affected primarily by growth in regulated prices and the impact of changes to indirect taxes (harmonisation changes to excise duties on tobacco products). The overall contribution of administrative effects, i.e. the changes to indirect taxes and regulated prices, to annual inflation will amount to 2 percentage points at the end of 2006 and 1.8 percentage points at the end of 2007. Adjusted inflation will gradually pick up as a result of rising inflation expectations amid an unwinding of the anti-inflationary effects of demand and the exchange rate. As in the previous forecast, only partial pass-through of the second-round effects of the growth in energy prices and regulated prices to other price categories is assumed. Food price growth will also gradually pick up. The average inflation rate will be 2.7% in 2006 and rise to 3.4% in 2007.

The mechanism of caveats will as usual apply to the first-round effects of indirect taxes, whose impact will be particularly pronounced in 2007, amounting to almost 1 percentage point. Adjusted for these effects, inflation to which monetary policy reacts remains below the point inflation target at the monetary policy horizon. It gradually converges towards it at the end of 2007.

Consistent with the macroeconomic forecast and its assumptions is interest rate stability initially and a gradual rise in rates thereafter. The risks to the baseline scenario identified in the forecasting process are perceived as broadly balanced. No full alternative scenario was identified in the forecasting process. Several sensitivity analyses were drawn up, relating to uncertainties regarding the short-term development of the exchange rate, the setting of the initial output gap and the outlook for foreign interest rates.

IV.4 EXPECTATIONS OF ECONOMIC AGENTS

The inflation outturns expected by financial market participants were unchanged, remaining below the CNB's inflation target. Analysts expect inflation to rise mainly due to growth in regulated prices. However, this factor should gradually subside. Pass-through of the rise in excise duty on cigarettes and of the partial rent deregulation is expected in 2006 and from 2007 onwards respectively. The relatively strong koruna remains the most substantial anti-inflationary factor. The inflation expectations of corporations also showed only minimal changes. A further fall in inflation expectations at the 12-month horizon was recorded for households, but their expectations have long been highly volatile.

The CNB also monitors inflation expectations at the three-year horizon. Their volatility is lower, as they are not affected by short-term factors. 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 showed minimal changes in the period under review over virtually the entire length of the yield curve. In line with the aforementioned CNB forecast, financial market participants did not expect any changes in the settings of the key interest rates in the immediate future. At the longer horizon, the interest rate path consistent with the CNB forecast was slightly above the path expected by financial market analysts.

MINUTES OF THE BOARD MEETING ON 23 FEBRUARY 2006

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 February situation report, which assessed the new information and the risks to the fulfilment of the forecast contained in the January situation report.

At 2.9%, inflation in January had been in line with the forecast. The dynamics of the individual components of inflation had also been as predicted. Administered prices and adjusted inflation had risen somewhat faster than forecasted, whereas food prices and fuel prices had been slightly lower.

The exchange rate component of the monetary conditions was still considerably stronger than forecasted, while the interest rate component was slightly easier. Information on the evolution of exogenous variables suggested a risk of lower economic growth and higher inflation in Germany in 2007 as a consequence of an increase in the basic VAT rate. However, the impacts of this risk on the Czech economy would be fairly limited. The assumptions regarding the development of euro area interest rates were being fulfilled, as were the assumptions about other exogenous variables and fiscal policy. Newly published supply-side information confirmed the assumptions of continued relatively high GDP growth in 2005 Q4. Annual monetary aggregate growth and credit growth were rising.

After the presentation of the situation report, the Board discussed the risks to the fulfilment of the January forecast. As in the previous month, the Board regarded these risks generally as being on the downside, although they had weakened slightly since the discussion of the January situation report. Unlike in the previous month, there had been a decrease in the uncertainty surrounding the upward path of interest rates in the euro area. The Board felt that the related widening of the negative interest rate differential against the euro might lead to a decrease in the attractiveness of investing in the Czech koruna and thus to a correction of the recent appreciation of its exchange rate, or at least to an easing of the pressures for further appreciation. The opinion was also expressed that, given the current exchange rate expectations, a slight increase in the negative interest rate differential against the euro would not in itself necessarily have any major effect on the appreciation pressures. Some of the members also drew attention to the present negative yield differential for long-term bonds.

The Board agreed that the exchange rate was still the main downside risk, remaining stronger than forecasted. The prevailing view was that this exchange rate development might be a non-systematic deviation. However, opinions were also expressed that the appreciation could be attributed to fundamentals such as foreign direct investment inflow, the buoyant GDP growth or increased export growth, which was being recorded despite the appreciation of the exchange rate. It was pointed out that monetary policy should not be driven by exchange rate developments, as a system of inflation targeting, not exchange rate targeting, was being operated. The opinion was also expressed that the current appreciation was linked with the influence of the global economy and was not necessarily a one-off and transitory shock.

In the context of the exchange rate, the Board turned its attention to the balance of payments. It was pointed out that recently it had been difficult to trace any link between the development of the balance of payments and the appreciation of the exchange rate, especially on the financial account, although the negative interest rate differential was now generating an outflow of portfolio investment.

The Board agreed that the pass-through of the growth in fuel prices and administered prices to other price categories was low. These pressures had so far been absorbed in large part by non-financial corporations. A surprisingly flexible supply response to changes in demand had been confirmed in the economy. Consequently, no major inflation pressures would emerge even if demand were to grow.

Some of the members drew attention to the forecast's over-optimistic assumptions regarding fiscal policy. The possibility of financing new expenditure using reserve funds could pose some upside risk compared to the forecast. The uncertainty surrounding the July elections might also be reflected in a rise in the risk premium.

The Board's discussion also touched on the rapid money supply growth and in particular the high growth in lending to all sectors of the economy.

The Board also turned its attention to monetary policy strategy. The prevailing view was that monetary policy should be forward looking and focus more on the long term. It was said that frequent adjustments to, and contrary movements in, nominal interest rates can destabilise the economy and in particular the investment decision-making of economic agents. Against this, the view was expressed that real, rather than nominal, interest rates are relevant to economic agents. The opinion was also expressed that the Board should not run the risk of a late monetary policy response to factors of monetary relevance. However, views were also expressed that trying too hard to fine tune monetary policy could be counterproductive.

After discussing the situation report, the Board decided by a majority vote to leave the two-week repo rate unchanged at 2%. Five members voted in favour of this decision, and one member voted for lowering interest rates by 0.25 percentage point.

MINUTES OF THE BOARD MEETING ON 30 MARCH 2006

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 March situation report, which analysed the new information and subsequently re-assessed the economic risks relating to the January forecast.

At 2.8%, inflation in February had been in line with the forecast. The downside risks to inflation associated with the January forecast had eased compared to February. Inflation would fluctuate below the inflation target in 2006 and then increase in 2007 as a result of harmonisation changes to taxes. The tightening of the monetary conditions through the exchange rate component had halted. The rapid money aggregate growth was continuing.

The most significant new information had been the high GDP growth figures for the final quarter of 2005 and the revisions to the previous quarters' data. Economic growth had been considerably higher in 2005 than predicted in the January forecast and than suggested by the leading indicators. Although the growth had exceeded the projected rate, no demand-pull inflationary pressures were emerging in the economy. The hypothesis was put forward that potential (non-inflationary) output might have risen faster than the January forecast had predicted. Another factor was that the economic growth was being driven by exports and investment, while household demand – which, if it were to rise quickly, might increase the pressure on inflation – was rising slowly.

After the presentation of the situation report, the Board discussed the new distribution of the risks relating to the January forecast and the implications of that new distribution for monetary policy. The easing of the downside risks of the inflation forecast had been caused primarily by a correction of the exchange rate of the koruna, by expectations of a rate increase in the euro area and probably also by the high economic growth in 2005. The Board agreed that the downside risks were smaller than in February and that the monetary policy rate settings were in line with economic developments.

The Board paid considerable attention to the new GDP growth figures for 2005. The Board stated that the economic growth had exceeded expectations and that the factors underlying it needed to be analysed carefully. Several hypotheses were put forward in this regard. It was said that the higher growth reflected structural changes in the economy and that these changes were leading to higher growth in potential output. The hypothesis was also expressed that the transmission of demand pressures to inflation depends on the structure of the growth and that export- and investment-led growth can generate far lower inflation pressures than growth driven by household consumption. It was also said that the GDP growth figures might partially reflect a change in the GDP calculation methodology or some other one-off factor. It was possible that a future data revision might alter the growth profile. The opinion was also expressed that the high growth of the economy might partially reflect the effect of the worsening terms of trade on the value of net exports at constant prices. It was also said that the GDP growth figures were difficult to interpret, because other economic indicators were not developing in line with the assumption of high growth. It was said that it would also be appropriate to analyse the evolution of real gross domestic income, which better corresponds to the terms of trade and inflation. In this context, it was also said several times that the GDP figures were reliable.

The Board went on to discuss the link between economic growth and demand-pull inflation. It was said repeatedly that the pick-up in GDP growth was not passing through to demand-pull inflation as significantly as might be expected using the standard demand model. The board members saw the causes of the weak demand pressure on inflation in several areas. It was said repeatedly that the reason was weak growth in household consumption, reflecting sluggish growth in disposable income. The view was also expressed that, in an environment of increasing international competition, no significant inflationary wage pressures could be expected going forward, either. It was said that the rising competition in the labour market resulting from labour migration into the Czech Republic was offsetting the low flexibility of the domestic labour market and easing the wage pressures on inflation. In this context it was also said that in a small open economy, demand pressures might initially show up in higher import growth rather than directly in inflation.

During the discussion of the link between growth and inflation the Board also debated the effect of fiscal policy on the economy. It was said that fiscal policy may be increasing the volatility of the economy. The fiscal impulse generated by some of the plans under discussion might in the short run foster appreciation of the currency and at the monetary policy horizon conversely create depreciation pressures. It was also said that the labour market might be affected as well, since higher social benefits might lead to a fall in employment. It was said that the high economic growth should not be an incentive for increased fiscal expansion and that, on the contrary, it should be exploited for a necessary fiscal correction. It was said repeatedly that failure to respect this rule would bring about a difficult-to-sustain fiscal trend that would further increase the volatility of the economy.

The Board also discussed the international context. It was said repeatedly that international comparison reveals that the Czech economy is developing rather atypically, as countries undergoing similar structural changes accompanied by currency appreciation typically experience rising consumer optimism and rising household demand. This dissimilarity was making economic analysis more difficult. It was also discussed whether the recent movement of the exchange rate was a reflection of developments in the region or whether it reflected the fact that the koruna is becoming a currency used by financial investors to finance their transactions. Attention was drawn to the expected development of the balance of payments, which does not rule out the net inflow of foreign direct investment being negative in 2006. It was said that this might also create pressure for a depreciation of the koruna. It was mentioned several times that the expected growth in foreign rates was an important factor in assessing the risks of the January forecast.

At the end of the meeting the Board decided unanimously to leave the two-week repo rate unchanged at 2%.

MINUTES OF THE BOARD MEETING ON 27 APRIL 2006

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 April situation report, which contained the new macroeconomic forecast. Compared to the January forecast there were changes in the expected effects of external factors, in particular higher world prices of oil. In addition, higher industrial producer price inflation – and subsequently higher consumer price inflation as well – was expected in Germany. The direct upward impact of these changes on domestic inflation was not too significant, but in the forecasting system the related higher outlook for Euribor rates was significantly affecting the interest rate path consistent with the forecast.

The Czech economy remained in a phase of high growth. Revisions to the 2005 GDP figures had increased this growth. Compared to the January forecast the expected economic growth was considerably higher, especially in the case of 2006. The new forecast predicted real GDP growth of 5.4%–6.9% in 2006 and 3.9%–6.9% in 2007. In the forecasting system the high real GDP growth had generated a rise in the rate of growth of the non-accelerating inflation level of output and, to a lesser extent, closure of the output gap at the turn of this year. The effect of demand on inflation was expected to be broadly neutral going forward.

The forecast was for annual consumer price inflation of 2.2%–3.6% in March 2007 and 3.2%–4.6% in September 2007. The slight decrease in the inflation forecast was due mainly to an anti-inflationary exchange rate effect and to lower-than-expected growth in food prices in the past period. As in the previous forecast, however, inflation exceeded the point inflation target from June 2007 onwards. The rise in inflation during 2007 would be a result primarily of a higher contribution from changes in indirect taxes, food prices and import prices excluding energy. However, monetary-relevant inflation (adjusted for the direct effects of tax rate changes) would stay just below the point inflation target in 2007.

Consistent with the macroeconomic forecast and its assumptions was interest rate stability initially and a gradual rise in rates thereafter.

After the presentation of the situation report, the Board discussed the uncertainties and risks associated with the forecast. The Board focused its attention on the interpretation of the higher-than-expected real GDP growth in 2005. It was said that the high growth last year was surprising, especially given that it was not translating fully into growth in inflation pressures. In this regard, the view was also expressed that any revision of last year's real GDP growth figures might change the current perceptions of the recent development of the economy.

The board members agreed that uncertainty also surrounded real GDP growth going forward. Both a further pick-up and a slowdown in economic growth were possible. However, it was also said that the fundamental view regarding the economy was qualitatively unchanged in the light of the new forecast. The economy could still be regarded as a fast growing and low-inflation one, especially with regard to monetary-relevant inflation. Based on the statistical data available, the prevailing view among the board members during the discussion was that the present economic situation could be described as favourable, with no major signs of unbalanced tendencies. Another prevailing view among the board members was that interest rates could now move in either direction. However, the key factor determining their future development would be information on the direction of the economy based on new statistical data.

The domestic risks were described by the board members as relatively insignificant overall. In this context, it was said that competition from foreign workers with low wage demands was a factor depressing wage growth. However, comments were made that the key factor underlying the subdued wage growth remained the persisting high unemployment, with its pronounced elements of structural unemployment. It was also said that although the rapid economic growth was having a positive effect on the fiscal outlook in the form of higher state budget revenues, this growth was nevertheless leaving the structural problems in public finances untackled.

The board members discussed the issue of the external risks in more detail, primarily with regard to the rise in oil prices. On the one hand, mention was made of the possibility of disturbances to the global economic equilibrium and a threat to world prosperity in the medium run. The complexity of the supply and demand effects associated with the oil price growth was also mentioned, and the view was expressed that the resultant effect of the oil price growth on inflation and interest rates would depend on the relative strength of these factors, which was currently difficult to determine in advance. The pass-through of the higher oil prices via cost pressures to oligopolistic industries with a high share of energy costs was also discussed. In this context, uncertainty regarding whether, and to what extent, the cost pressures would translate from declining profit margins into prices was expressed in the discussion. On the other hand, attention was drawn to the possibility of the global cost shocks being dampened by energy-saving technological innovations and also to the possibility that the oil price growth would be eased by the development of the exchange rate of the koruna.

During the discussion of the risks, the Board also addressed the undershooting of the inflation target in past years. In this context, the need for a symmetric reaction to inflation movements in both the lower and upper half of the tolerance band of the point inflation target was pointed out.

The board members expressed various opinions during the overall assessment of the risks. The prevailing view, however, was that the risks of the forecast were balanced.

After discussing the April situation report, the Board decided unanimously to leave the two-week repo rate unchanged at 2%.

Table 1a

INFLATION DEVELOPMENT												annual percentage changes
2002	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**
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	2.6	2.4	2.2
Regulated prices	2.9	2.9	2.9	3.1	4.0	5.8	6.6	6.8	6.8	9.0	9.0	9.0
(contribution to consumer price inflation)	*0.61*	*0.60*	*0.61*	*0.66*	*0.83*	*1.21*	*1.38*	*1.41*	*1.41*	*1.87*	*1.87*	*1.87*
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*	*-0.06*	*-0.05*	*0.00*
Net inflation	0.9	0.9	0.7	0.8	0.6	0.7	0.4	0.4	1.1	1.0	0.8	0.4
(contribution to consumer price inflation)	*0.72*	*0.75*	*0.59*	*0.68*	*0.46*	*0.53*	*0.35*	*0.35*	*0.89*	*0.80*	*0.65*	*0.32*
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	0.3	0.3	-0.7
(contribution to consumer price inflation)	*0.11*	*0.17*	*0.12*	*-0.02*	*-0.03*	*0.04*	*-0.15*	*-0.17*	*-0.05*	*0.07*	*0.08*	*-0.17*
adjusted inflation	1.1	1.1	0.9	1.3	0.9	0.9	0.9	1.0	1.8	1.4	1.1	0.9
(contribution to consumer price inflation)	*0.61*	*0.59*	*0.47*	*0.69*	*0.49*	*0.48*	*0.50*	*0.52*	*0.94*	*0.74*	*0.57*	*0.49*
Inflation rate (annual moving average)	2.8	2.7	2.6	2.6	2.5	2.4	2.2	2.1	2.0	2.0	1.9	1.9
2006												
Consumer prices	2.9	2.8	2.8									
Regulated prices	11.0	11.0	11.2									
(contribution to consumer price inflation)	*2.27*	*2.28*	*2.30*									
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.21*	*0.34*	*0.39*									
Net inflation	0.5	0.3	0.1									
(contribution to consumer price inflation)	*0.40*	*0.23*	*0.08*									
of which: prices of food, beverages and tobacco	-1.0	-1.6	-1.8									
(contribution to consumer price inflation)	*-0.25*	*-0.41*	*-0.47*									
adjusted inflation	1.2	1.2	1.0									
(contribution to consumer price inflation)	*0.65*	*0.64*	*0.55*									
Inflation rate (annual moving average)	2.0	2.1	2.2									

CNB calculation based on CZSO data

Table 1b

INFLATION DEVELOPMENT												monthly percentage changes
2002	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**
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	0.9	-0.3	-0.1
Regulated prices	2.2	0.2	0.1	-0.2	0.1	1.8	0.8	0.0	0.0	3.7	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*	*0.78*	*0.00*	*0.00*
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*	*0.00*	*0.00*	*0.05*
Net inflation	0.3	0.2	-0.1	0.1	0.2	0.2	0.2	0.0	-0.3	0.1	-0.2	-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*	*0.05*	*-0.20*	*-0.20*
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	0.4	0.1	0.1
(contribution to consumer price inflation)	*0.12*	*0.01*	*-0.02*	*-0.06*	*0.12*	*0.05*	*-0.33*	*-0.17*	*-0.04*	*0.11*	*0.02*	*0.03*
adjusted inflation	0.3	0.2	-0.1	0.3	0.1	0.3	0.9	0.3	-0.4	-0.1	-0.4	-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*	*-0.06*	*-0.22*	*-0.23*
2006												
Consumer prices	1.4	0.1	-0.1									
Regulated prices	4.1	0.2	0.2									
(contribution to consumer price inflation)	*0.89*	*0.04*	*0.03*									
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.16*	*0.13*	*0.05*									
Net inflation	0.4	-0.1	-0.3									
(contribution to consumer price inflation)	*0.33*	*-0.05*	*-0.21*									
of which: prices of food, beverages and tobacco	0.2	-0.6	-0.3									
(contribution to consumer price inflation)	*0.04*	*-0.15*	*-0.08*									
adjusted inflation	0.5	0.2	-0.2									
(contribution to consumer price inflation)	*0.29*	*0.10*	*-0.12*									

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 - 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
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	16.1	15.8	15.7	15.0
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	5.0	5.2	5.6	6.0
Alcoholic beverages and tobacco	79.2	12.6	12.8	12.7	12.3	12.3	12.5	12.4	12.4	12.3	12.4	12.3	12.4	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	-20.1	-20.0	-20.2	-19.1
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	38.9	38.9	38.9	36.1
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	-6.4	-6.5	-6.6	-6.0
Health	14.3	25.5	26.1	26.7	27.3	29.1	30.1	30.2	30.4	31.0	29.9	29.5	29.5	28.8
Transport	101.4	3.9	3.7	4.1	6.8	6.9	7.8	9.5	9.6	13.6	13.0	11.1	8.8	8.2
Communications	22.5	21.0	20.1	20.1	20.0	19.9	38.6	39.0	39.0	38.2	38.2	38.1	38.1	30.9
Recreation and culture	95.5	9.8	11.4	10.1	8.9	9.4	10.1	15.8	18.1	10.1	11.2	10.6	10.5	11.3
Education	4.5	14.9	15.6	15.8	15.8	15.8	15.6	15.6	15.6	19.5	20.2	20.2	20.2	17.1
Hotels, cafés and restaurants	74.2	20.4	21.0	21.2	21.5	21.4	21.5	21.2	21.2	22.4	22.8	22.8	22.8	21.7
Miscellaneous goods and services	49.5	20.3	20.9	20.9	20.9	20.8	20.7	20.7	20.6	20.7	20.8	20.9	20.9	20.8
Total - 2006	1,000.0	17.3	17.4	17.3										17.3
Food and non-alcoholic beverages	197.6	6.4	6.2	6.0										6.2
Alcoholic beverages and tobacco	79.2	13.5	13.7	13.7										13.6
Clothing and footwear	56.9	-22.1	-23.0	-23.2										-22.8
Housing, water, electricity, gas and other fuels	236.4	44.1	44.4	44.5										44.3
Furnishings, household equipment and routine maintenance of the house	67.9	-6.8	-6.8	-7.0										-6.9
Health	14.3	30.9	31.3	32.3										31.5
Transport	101.4	8.5	8.7	8.5										8.6
Communications	22.5	38.8	36.0	36.0										36.9
Recreation and culture	95.5	12.0	13.3	12.1										12.5
Education	4.5	20.1	20.2	20.1										20.1
Hotels, cafés and restaurants	74.2	23.6	24.0	24.1										23.9
Miscellaneous goods and services	49.5	21.9	22.5	22.7										22.4

Source: CZSO

Table 3

CONSUMER PRICES - TRADABLES AND NONTRADABLES

percentage changes; December 1999 = 100

Group	Constant 1999 weights in per mille	2002 12	2003 12	2004 12	2005 3	2005 6	2005 9	2005 12	2006 3
1. Food and non-alcoholic beverages	197.6	2.1	5.7	6.6	6.8	7.5	4.4	5.6	6.0
- tradables	197.6	2.1	5.7	6.6	6.8	7.5	4.4	5.6	6.0
2. Alcoholic beverages and tobacco	79.2	7.1	7.8	11.6	12.7	12.5	12.3	12.4	13.7
- tradables	79.2	7.1	7.8	11.6	12.7	12.5	12.3	12.4	13.7
3. Clothing and footwear	56.9	-7.7	-11.9	-14.6	-18.4	-18.3	-20.6	-20.2	-23.2
- nontradables	1.4	18.3	21.1	35.9	36.9	37.1	37.6	38.4	40.8
- tradables	55.5	-8.4	-12.7	-15.9	-19.8	-19.7	-22.1	-21.7	-24.8
4. Housing, water, electricity, gas and other fuels	236.4	24.3	26.6	32.2	35.1	35.0	35.8	38.9	44.5
- nontradables	226.1	25.2	27.5	33.2	36.2	36.1	36.9	40.1	45.9
- tradables	10.3	4.0	5.9	10.7	11.9	10.6	12.0	12.4	12.6
5. Furnishings, household equipment and routine maintenance of the house	67.9	-1.0	-3.0	-4.9	-5.5	-5.9	-6.4	-6.6	-7.0
- nontradables	2.9	9.9	12.3	16.8	15.7	16.5	17.1	17.3	19.0
- tradables	65.0	-1.5	-3.7	-5.9	-6.5	-6.9	-7.5	-7.7	-8.2
6. Health	14.3	12.8	16.4	20.6	26.7	30.1	31.0	29.5	32.3
- nontradables	11.0	15.4	19.9	25.2	33.2	37.4	38.5	36.5	40.0
- tradables	3.3	4.4	5.1	5.6	5.7	6.4	6.4	6.7	7.1
7. Transport	101.4	4.1	3.6	5.0	4.1	7.8	13.6	8.8	8.5
- nontradables	27.4	16.0	18.4	23.0	24.4	24.7	26.3	26.8	28.6
- tradables	74.0	-0.3	-1.9	-1.6	-3.4	1.5	8.9	2.1	1.1
8. Communications	22.5	8.2	7.2	21.0	20.1	38.6	38.2	38.1	36.0
- nontradables	21.0	2.1	2.3	16.6	15.8	46.8	46.5	46.5	46.5
- tradables	1.5	95.9	77.5	83.6	82.0	-79.0	-80.8	-82.3	-85.8
9. Recreation and culture	95.5	7.2	6.1	7.9	10.1	10.1	10.1	10.5	12.1
- nontradables	60.4	16.2	16.7	21.2	25.0	26.2	26.8	27.4	30.0
- tradables	35.1	-8.3	-12.1	-15.0	-15.5	-17.7	-18.7	-18.6	-18.7
10. Education	4.5	11.3	12.0	18.1	15.8	15.6	19.5	20.2	20.1
- nontradables	4.5	11.3	12.0	18.1	15.8	15.6	19.5	20.2	20.1
11. Hotels, cafés and restaurants	74.2	8.7	10.8	19.6	21.2	21.5	22.4	22.8	24.1
- nontradables	74.2	8.7	10.8	19.6	21.2	21.5	22.4	22.8	24.1
12. Miscellaneous goods and services	49.5	11.9	15.2	20.3	20.9	20.7	20.7	20.9	22.7
- nontradables	22.0	25.8	36.4	48.4	50.3	50.7	51.2	51.5	55.4
- tradables	27.5	0.8	-1.7	-2.2	-2.6	-3.2	-3.6	-3.5	-3.4
Household consumer prices, total	1,000.0	9.0	10.1	13.2	14.1	15.0	15.1	15.7	17.3
Tradables	549.1	0.6	0.7	0.9	0.4	0.6	0.1	-0.3	-0.6
- food	276.8	3.5	6.3	8.0	8.5	8.9	6.7	7.5	8.2
- others	272.3	-2.4	-5.0	-6.3	-7.8	-7.8	-6.5	-8.3	-9.5
Nontradables	450.9	19.2	21.6	28.2	30.8	32.6	33.4	35.2	39.1
- others	271.2	16.5	19.4	26.9	28.9	29.5	33.1	32.8	35.1
- regulated	179.7	23.2	24.9	30.3	33.7	37.3	33.8	38.8	45.0

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
1/02	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
10/05	2.7	—	—
11/05	2.8	—	—
12/05	2.6	2.8	4.6
1/06	2.5	—	—
2/06	2.5	—	—
3/06	2.5	2.7	4.1

Source: CNB statistical survey

Table 5

HARMONISED INDEX OF CONSUMER PRICES annual percentage changes

	2002	2003	2004	2005	2006
	12	12	12	12	3
European Union (25 countries)	2.1	1.9	2.4	2.1	2.1
European Union (15 countries)	2.2	1.8	2.2	2.2	2.1
Belgium	1.3	1.7	1.9	2.8	2.2
Czech Republic	0.1	0.9	2.5	1.9	2.4
Denmark	2.6	1.2	0.9	2.2	1.8
Germany	1.2	1.0	2.3	2.1	1.9
Estonia	2.7	1.2	4.8	3.6	4.0
Greece	3.5	3.1	3.1	3.5	3.3
Spain	4.0	2.7	3.3	3.7	3.9
France	2.2	2.4	2.3	1.8	1.7
Ireland	4.6	3.0	2.4	1.9	2.8
Italy	2.9	2.5	2.4	2.1	2.2
Cyprus	3.1	2.2	3.9	1.4	2.6
Latvia	1.5	3.5	7.4	7.1	6.6
Lithuania	-0.9	-1.3	2.8	3.0	3.1
Luxembourg	2.8	2.4	3.5	3.4	3.7
Hungary	4.9	5.6	5.5	3.3	2.4
Malta	2.1	2.4	1.9	3.4	2.9
Netherlands	3.2	1.6	1.2	2.0	1.4
Austria	1.7	1.3	2.5	1.6	1.3
Poland	0.8	1.6	4.4	0.8	0.9
Portugal	4.0	2.3	2.6	2.5	3.0
Slovenia	7.1	4.7	3.3	2.4	2.0
Slovakia	3.2	9.4	5.8	3.9	4.3
Finland	1.7	1.2	0.1	1.1	1.2
Sweden	1.6	1.8	0.9	1.3	1.5
United Kingdom	1.7	1.3	1.7	1.9	

Source: Eurostat

Table 6

MONETARY SURVEY					position at month-end in CZK billions
	2002	2003	2004	2005	2006
	12	12	12	12	3
Total assets	1,651.8	1,766.1	1,844.1	1,992.0	1,990.7
Net external assets (NEAs)	926.1	821.5	863.3	1,076.4	1,046.0
NEAs of CNB	715.6	687.5	634.1	724.7	708.8
NEAs of OMFIs	210.5	134.0	229.3	351.6	337.1
Net domestic assets	725.8	944.5	980.8	915.6	944.8
Domestic loans	940.0	1,145.6	1,147.0	1,166.6	1,194.5
Net credit to government (NCG) (including securities)	215.8	354.0	257.5	99.2	103.4
NCG to central government (including securities)	260.4	408.7	312.4	163.2	184.1
NCG to other government (including securities)	-44.6	-54.8	-54.9	-64.0	-80.7
Loans to corporations and households					
(excluding securities)	724.2	791.6	889.4	1,067.4	1,091.1
Loans to corporations (excluding securities)	542.7	554.1	574.2	649.6	663.1
Loans to households (excluding securities)	181.5	237.5	315.2	417.8	428.0
Other net items (including securities and capital)	-214.3	-201.1	-166.2	-251.0	-249.7
Holdings of securities	18.5	16.6	18.8	14.4	14.5
Issued securities	-48.6	-51.6	-74.9	-119.1	-120.3
Liabilities					
Monetary aggregate M2	1,651.8	1,766.1	1,844.1	1,992.0	1,990.7
Monetary aggregate M1	787.7	902.8	962.3	1,087.2	1,100.1
Currency in circulation	197.8	221.4	236.8	263.8	264.8
Overnight deposits	589.9	681.4	725.6	823.4	835.3
Overnight deposits - households	315.6	372.1	410.8	456.5	478.1
Overnight deposits - corporations	274.3	309.3	314.7	366.9	357.2
M2-M1 (quasi money)	864.1	863.3	881.8	904.8	890.6
Deposits with agreed maturity	651.2	666.4	675.3	671.3	660.8
Deposits with agreed maturity - households	448.6	439.8	458.6	445.1	436.4
Deposits with agreed maturity - corporations	202.5	226.6	216.7	226.3	224.4
Deposits redeemable at notice	194.3	185.6	198.8	224.1	216.8
Deposits redeemable at notice - households	190.7	182.3	194.6	220.6	213.3
Deposits redeemable at notice - corporations	3.6	3.2	4.2	3.6	3.5
Repurchase agreements	18.6	11.3	7.6	9.3	13.0
Annual percentage changes					
M1	35.0	14.6	6.6	13.0	14.2
M2	3.5	6.9	4.4	8.0	7.9
Loans to corporations and households	-6.6	9.3	12.4	20.0	20.0
M2-M1 (deposits)	-14.6	-0.1	2.1	2.6	1.1
Annual percentage growth rates					
M1	__	15.5	8.3	13.1	14.4
M2	__	8.1	5.8	8.1	8.1
Loans to corporations and households	__	11.8	15.3	20.7	20.8
M2-M1 (deposits)	__	1.2	3.3	2.6	1.3

Table 7

INTEREST RATES ON INTERBANK DEPOSITS

percentages

	2002 12	2003 12	2004 12	2005 12	2006 3
1. Average PRIBOR [1]					
- 1 day	2.75	1.98	2.49	2.00	1.99
- 7 day	2.76	2.02	2.51	2.04	2.02
- 14 day	2.76	2.03	2.51	2.04	2.02
- 1 month	2.73	2.04	2.53	2.05	2.04
- 2 month	2.67	2.06	2.55	2.10	2.06
- 3 month	2.63	2.08	2.57	2.17	2.08
- 6 month	2.60	2.13	2.67	2.33	2.16
- 9 month	2.60	2.22	2.76	2.44	2.23
- 12 month	2.60	2.30	2.85	2.53	2.32
2. Average PRIBID [1]					
- 1 day	2.65	1.88	2.39	1.90	1.89
- 7 day	2.67	1.92	2.41	1.94	1.92
- 14 day	2.67	1.93	2.41	1.94	1.92
- 1 month	2.64	1.94	2.43	1.95	1.94
- 2 month	2.57	1.96	2.45	2.00	1.96
- 3 month	2.54	1.98	2.47	2.07	1.98
- 6 month	2.51	2.03	2.57	2.23	2.06
- 9 month	2.51	2.12	2.66	2.34	2.13
- 12 month	2.51	2.20	2.75	2.43	2.22

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

Table 8

FRA RATES					percentages; monthly averages
	2002	2003	2004	2005	2006
	12	12	12	12	3
3 * 6	2.52	2.23	2.74	2.46	2.24
3 * 9	2.54	2.36	2.81	2.57	2.33
6 * 9	2.52	2.47	2.85	2.66	2.41
6 * 12	2.58	2.64	2.92	2.74	2.52
9 * 12	2.61	2.77	2.97	2.79	2.61
9*12 - 3*6 spread	0.10	0.55	0.24	0.33	0.37
6*12 - 3*9 spread	0.04	0.28	0.12	0.17	0.18

IRS RATES					percentages; monthly averages
	2002	2003	2004	2005	2006
	12	12	12	12	3
1Y	2.63	2.41	2.82	2.56	2.37
2Y	2.85	2.98	3.06	2.82	2.73
3Y	3.18	3.38	3.27	3.00	2.96
4Y	3.46	3.69	3.45	3.13	3.12
5Y	3.70	3.93	3.62	3.25	3.24
6Y	3.91	4.13	3.77	3.33	3.34
7Y	4.08	4.29	3.89	3.40	3.42
8Y	4.23	4.43	4.00	3.46	3.48
9Y	4.36	4.54	4.09	3.52	3.55
10Y	4.47	4.64	4.17	3.58	3.62
15Y	4.77	4.97	4.40	3.78	3.83
20Y	—	5.11	4.54	3.88	3.94
5Y - 1Y spread	1.07	1.52	0.80	0.69	0.87
10Y - 1Y spread	1.84	2.23	1.35	1.02	1.25

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
1/02	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	5.1	1.5	-0.4	-0.3	2.8	-0.7	0.8	0.9	4.1
10/05	1.8	2.2	5.6	1.5	-0.8	-0.4	2.9	-1.1	1.5	1.9	5.3
11/05	2.0	2.6	5.4	1.7	-0.4	0.2	2.9	-0.7	2.0	2.6	5.4
12/05	2.0	2.5	5.5	1.7	-0.2	0.3	3.2	-0.5	2.3	2.8	5.8
1/06	2.0	2.4	5.5	1.7	-0.8	-0.5	2.6	-1.2	1.7	2.1	5.2
2/06	2.0	2.2	5.5	1.7	-0.8	-0.6	2.6	-1.1	1.7	1.9	5.2
3/06	2.0	2.3	—	—	-0.8	-0.5	—	—	1.7	2.0	—

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

Table 10

REAL INTEREST RATES (ex ante approach)

percentages

	Real rates expected by financial markets				Real rates expected by businesses				Real rates expected by households			
	PRIBOR		client rates		PRIBOR		client rates		PRIBOR		client rates	
	2W	1Y	new loans	time deposits	2W	1Y	new loans	time deposits	2W	1Y	new loans	time deposits
1/02	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	2.5	-1.0	-1.0	-0.9	2.2	-1.3	-3.3	-3.2	-0.1	-3.6
10/05	-0.9	-0.5	2.8	-1.1	—	—	—	—	—	—	—	—
11/05	-0.7	-0.2	2.5	-1.1	—	—	—	—	—	—	—	—
12/05	-0.5	-0.1	2.8	-0.9	-0.8	-0.3	2.6	-1.1	-2.5	-2.0	0.8	-2.8
1/05	-0.5	-0.1	3.0	-0.8	—	—	—	—	—	—	—	—
2/05	-0.5	-0.3	2.9	-0.8	—	—	—	—	—	—	—	—
3/05	-0.5	-0.2	—	—	-0.7	-0.4	—	—	-2.0	-1.7	—	—

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

	2002 12	2003 12	2004 12	2005 12	2006 2
Koruna interest rates on loans provided by banks to residents:					
Households and non-profit institutions serving households (S.14+S.15) - total	8.77	8.24	7.96	7.20	7.07
- maturity up to 1 year	10.35	11.21	12.82	12.96	12.96
- maturity over 1 year and up to 5 years	10.80	10.17	12.40	11.43	11.40
- maturity over 5 years	7.35	6.65	6.39	5.96	5.90
for consumption - total	13.83	13.83	14.89	13.88	13.79
- maturity up to 1 year	13.05	14.26	15.48	16.22	16.34
- maturity over 1 year and up to 5 years	14.48	13.86	15.17	14.94	14.89
- maturity over 5 years	12.55	13.21	13.45	11.85	11.83
for house purchase - total	7.11	6.31	5.93	5.24	5.16
- maturity up to 1 year	7.67	6.24	4.48	4.29	4.57
- maturity over 1 year and up to 5 years	7.90	7.05	6.57	6.22	6.19
- maturity over 5 years	6.88	6.09	5.89	5.19	5.12
other - total	6.99	7.80	7.50	7.09	7.00
- maturity up to 1 year	6.64	8.49	8.96	9.09	9.04
- maturity over 1 year and up to 5 years	6.34	8.02	7.63	7.17	7.24
- maturity over 5 years	7.61	7.02	6.58	5.79	5.70
Non-financial corporations (S.11) - total	5.19	4.53	4.75	4.20	4.17
- maturity up to 1 year	4.34	4.08	4.35	3.84	3.80
- maturity over 1 year and up to 5 years	5.47	4.64	4.68	4.18	4.18
- maturity over 5 years	6.34	5.14	5.39	4.72	4.65
Koruna interest rates on deposits accepted by banks from residents:					
Households and non-profit institutions serving households (S.14+S.15) - total	1.72	1.30	1.41	1.25	1.23
overnight	0.94	0.50	0.52	0.40	0.40
with agreed maturity - total	2.26	2.02	2.13	1.92	1.90
- with agreed maturity up to 2 years	1.68	0.96	1.37	1.03	1.03
- with agreed maturity over 2 years	3.04	2.90	2.69	2.50	2.48
redeemable at notice - total	1.81	1.26	1.63	1.71	1.75
- redeemable at notice up to 3 months	1.93	1.67	2.14	2.27	2.26
- redeemable at notice over 3 months	1.73	0.98	1.12	0.81	0.79
Non-financial corporations (S.11) - total	1.25	0.85	1.21	0.91	0.95
overnight	0.94	0.64	0.68	0.52	0.55
with agreed maturity - total	2.16	1.50	2.08	1.64	1.62
- with agreed maturity up to 2 years	2.15	1.49	2.05	1.61	1.60
- with agreed maturity over 2 years	3.47	3.04	3.12	2.47	2.46
redeemable at notice - total	1.64	1.17	1.60	1.14	1.17
- redeemable at notice up to 3 months	1.60	1.14	1.49	1.07	1.11
- redeemable at notice over 3 months	2.26	1.32	2.26	1.64	1.67

Table 12

BALANCE OF PAYMENTS [1]					in CZK millions
	2001 Q1 - 4	2002 Q1 - 4	2003 Q1 - 4	2004 Q1 - 4	2005 [2] Q1 - 4
A. Current account	-124,478.3	-136,378.1	-160,614.6	-167,348.2	-61,670.2
Balance of trade [3]	-116,685.0	-71,323.0	-69,793.0	-26,438.0	40,354.0
exports	1,269,634.0	1,254,394.0	1,370,930.0	1,722,657.0	1,875,219.0
imports	1,386,319.0	1,325,717.0	1,440,723.0	1,749,095.0	1,834,865.0
Services	57,984.9	21,850.8	13,236.7	12,539.3	19,411.8
credit	269,689.6	231,131.1	219,151.1	248,535.1	257,998.4
transport	57,492.3	56,560.5	60,556.3	72,308.9	78,763.0
travel	118,133.0	96,289.2	100,310.1	107,231.8	110,948.0
others	94,064.3	78,281.4	58,284.7	68,994.4	68,287.4
debit	211,704.7	209,280.3	205,914.4	235,995.8	238,586.6
transport	30,570.5	29,332.8	33,725.7	38,603.0	43,135.9
travel	52,802.0	51,549.3	54,419.2	58,398.0	57,777.6
others	128,332.2	128,398.2	117,769.5	138,994.8	137,673.1
Income	-83,548.9	-115,615.0	-119,858.4	-157,772.9	-142,318.3
credit	84,892.3	66,790.1	75,508.3	87,040.1	112,322.7
debit	168,441.2	182,405.1	195,366.7	244,813.0	254,641.0
Current transfers	17,770.7	28,709.1	15,800.1	4,323.4	20,882.3
credit	36,404.9	46,709.0	46,976.7	46,777.3	75,639.7
debit	18,634.2	17,999.9	31,176.6	42,453.9	54,757.4
B. Capital account	-330.7	-119.4	-82.2	-14,017.0	5,059.2
credit	90.4	221.0	198.2	5,608.2	5,731.1
debit	421.1	340.4	280.4	19,625.2	671.9
Total A a B	*-124,809.0*	*-136,497.5*	*-160,696.8*	*-181,365.2*	*-56,611.0*
C. Financial account	172,849.9	347,827.4	157,093.5	183,659.9	137,925.6
Direct investment	208,296.1	270,930.2	53,500.3	101,776.3	242,706.1
abroad	-6,289.2	-6,759.3	-5,815.7	-26,067.3	-20,500.1
equity capital and reinvested earnings	-5,848.5	-5,376.8	-3,124.6	-20,260.0	-11,372.3
other capital	-440.7	-1,382.5	-2,691.1	-5,807.3	-9,127.8
in the Czech Republic	214,585.3	277,689.5	59,316.0	127,843.6	263,206.2
equity capital and reinvested earnings	185,981.4	270,061.0	59,350.4	121,482.9	262,791.9
other capital	28,603.9	7,628.5	-34.4	6,360.7	414.3
Portfolio investment	34,857.3	-46,748.7	-35,719.1	59,380.4	-72,002.0
assets	4,405.6	-75,602.1	-83,892.7	-63,897.3	-72,853.9
equity securities	9,447.8	-7,807.9	5,630.5	-30,109.2	-26,036.2
debt securities	-5,042.2	-67,794.2	-89,523.2	-33,788.1	-46,817.7
liabilities	30,451.7	28,853.4	48,173.6	123,277.7	851.9
equity securities	23,203.6	-9,035.7	30,133.5	19,558.6	-36,408.9
debt securities	7,248.1	37,889.1	18,040.1	103,719.1	37,260.8
Financial derivatives	-3,220.3	-4,281.7	3,860.1	-3,208.0	-2,801.8
assets	-9,407.6	-15,458.4	7,083.7	-15,565.8	-1,668.4
liabilities	6,187.3	11,176.7	-3,223.6	12,357.8	-1,133.4
Other investment	-67,083.2	127,927.6	135,452.2	25,711.2	-29,976.7
assets	-46,144.5	133,121.8	67,071.3	-30,507.4	-104,419.1
long-term	1,325.8	28,711.4	1,141.3	20,434.2	-16,360.9
CNB	—	—	—	-184.9	-176.3
commercial banks	-4,125.8	5,271.7	-999.9	505.0	-24,664.6
government	6,928.9	25,333.6	5,714.3	22,790.7	14,056.5
other sectors	-1,477.3	-1,893.9	-3,573.1	-2,676.6	-5,576.5
short-term	-47,470.3	104,410.4	65,930.0	-50,941.6	-88,058.2
commercial banks	-45,523.2	122,163.8	44,971.2	-34,248.5	-87,102.6
government	-87.1	-2,237.4	2,193.8	92.9	9.4
other sectors	-1,860.0	-15,516.0	18,765.0	-16,786.0	-965.0
liabilities	-20,938.7	-5,194.2	68,380.9	56,218.6	74,442.4
long-term	-4,262.6	2,853.8	26,361.6	36,550.9	50,238.9
CNB	-22.0	-20.2	-20.4	-20.5	-19.1
commercial banks	-7,222.2	-8,059.2	-5,038.0	-1,410.8	311.0
government	-5,000.8	-1,517.2	10,304.7	10,296.1	20,815.1
other sectors	7,982.4	12,450.4	21,115.3	27,686.1	29,131.9
short-term	-16,676.1	-8,048.0	42,019.3	19,667.7	24,203.5
CNB	59.7	-24.3	-21.4	843.7	5,060.1
commercial banks	-35,688.6	-3,871.2	37,899.4	-15,344.5	14,802.0
government	—	—	—	—	—
other sectors	18,952.8	-4,152.5	4,141.3	34,168.5	4,341.4
Total A + B + C	*48,040.9*	*211,329.9*	*-3,603.3*	*2,294.7*	*81,314.6*
D. Net errors and omissions, valuation changes	19,112.1	5,615.1	16,506.7	4,487.5	11,537.0
Total A + B + C + D	*67,153.0*	*216,945.0*	*12,903.4*	*6,782.2*	*92,851.6*
E. Change in reserves (- increase)	-67,153.0	-216,945.0	-12,903.4	-6,782.2	-92,851.6

1) Balance of payments structure based on the Balance of Payments Manual (5th edition), IMF 1993
2) Preliminary data
3) In accordance with customs statistics methodology in force since 1 July 2000

Table 13

INTERNATIONAL INVESTMENT POSITION

in CZK millions

	2001 31 Dec.	2002 31 Dec.	2003 31 Dec.	2004 31 Dec.	2005[1)] 31 Dec.
Assets	1,544,963.0	1,579,922.9	1,537,284.6	1,549,333.7	1,823,960.2
Direct investment abroad	41,176.1	44,397.1	58,581.5	84,087.4	104,235.0
- equity capital	37,633.6	39,472.1	50,965.5	70,664.0	81,315.0
- other capital	3,542.5	4,925.0	7,616.0	13,423.4	22,920.0
Portfolio investment	185,138.6	274,344.7	343,968.7	372,237.6	428,697.7
- equity securities	68,675.5	86,464.7	47,337.7	76,121.3	107,846.8
- debt securities	116,463.1	187,880.0	296,631.0	296,116.3	320,850.9
Financial derivatives	15,754.8	31,213.2	24,129.5	39,695.3	41,363.7
Other investment	778,435.7	515,356.2	419,090.0	417,071.9	522,961.8
long-term	310,133.9	179,639.6	157,598.6	118,432.7	136,313.4
- CNB	307.3	280.9	468.4	600.0	3,184.5
- commercial banks	79,663.7	67,966.9	66,121.3	58,137.8	83,230.4
- government	210,694.9	97,156.8	79,483.9	48,574.9	38,408.5
- other sectors	19,468.0	14,235.0	11,525.0	11,120.0	11,490.0
short-term	468,301.8	335,716.6	261,491.4	298,639.2	386,648.4
- CNB	51.2	376.7	98.8	71.7	71.1
- commercial banks	359,638.5	213,815.4	161,150.2	184,588.0	273,797.2
of which: gold and foreign exchange	257,138.6	163,032.9	115,884.8	128,119.8	197,959.6
- government	87.1	2,324.5	102.4	9.5	0.1
- other sectors	108,525.0	119,200.0	100,140.0	113,970.0	112,780.0
CNB reserves	524,457.8	714,611.7	691,514.9	636,241.5	726,702.0
- gold	4,469.9	4,653.8	4,784.3	4,253.9	5,526.8
- SDR	31.0	137.1	238.7	118.0	289.8
- reserve position in the IMF	5,478.3	7,081.5	11,949.9	9,137.5	4,447.7
- foreign exchange	514,188.0	686,516.1	674,451.8	622,606.4	716,315.2
- other reserve assets	290.6	16,223.2	90.2	125.7	122.5
Liabilities	1,789,030.7	1,977,177.7	2,064,768.3	2,374,328.4	2,680,707.6
Direct investment in the Czech Republic	982,335.0	1,165,529.1	1,161,783.6	1,280,594.8	1,461,976.8
- equity capital	837,537.3	1,013,102.9	1,009,391.8	1,121,842.3	1,303,621.8
- other capital	144,797.7	152,426.2	152,391.8	158,752.5	158,355.0
Portfolio investment	180,346.2	201,120.0	223,620.4	381,019.4	437,806.0
- equity securities	128,740.1	128,097.7	140,788.6	208,872.1	220,495.8
- debt securities	51,606.1	73,022.3	82,831.8	172,147.3	217,310.2
Financial derivatives	11,495.2	22,671.9	19,448.3	31,806.1	30,672.7
Other investment	614,854.3	587,856.7	659,916.0	680,908.1	750,252.1
long-term	332,593.2	326,321.3	360,279.2	373,456.4	418,926.2
- CNB	133.4	114.5	96.1	70.2	47.8
- commercial banks	73,688.6	63,541.0	58,056.3	52,020.8	51,639.7
- government	9,476.2	9,475.8	22,456.0	32,065.4	52,372.7
- other sectors	249,295.0	253,190.0	279,670.8	289,300.0	314,866.0
short-term	282,261.1	261,535.4	299,636.8	307,451.7	331,325.9
- CNB	68.5	44.2	22.8	866.5	5,926.5
- commercial banks	190,487.6	176,196.2	208,534.0	185,025.2	201,239.4
- government	—	—	—	—	—
- other sectors	91,705.0	85,295.0	91,080.0	121,560.0	124,160.0
Net investment position	-244,067.7	-397,254.8	-527,483.7	-824,994.7	-856,747.4

1) Preliminary data

Table 14

EXTERNAL DEBT					in CZK millions
	2001 31 Dec.	2002 31 Dec.	2003 31 Dec.	2004 31 Dec.	2005[1)] 31 Dec.
Debt in convertible currencies	811,258.1	813,305.2	895,139.6	1,011,807.9	1,125,917.3
of which:					
Long-term	465,687.8	498,833.8	535,995.9	667,327.6	772,917.0
by debtor					
- CNB	133.4	114.5	96.1	70.2	47.8
- commercial banks	88,401.4	80,063.7	73,276.4	64,346.5	65,418.8
- government	30,839.2	47,701.3	69,029.9	147,729.1	221,054.0
- other sectors	346,313.8	370,954.3	393,593.5	455,181.8	486,396.4
by creditor					
- foreign banks	229,305.5	230,589.8	251,535.3	269,081.3	284,541.7
- government institutions	2,373.6	1,747.2	—	—	9,636.0
- multilateral institutions	70,879.0	69,894.7	83,779.6	84,862.4	98,520.8
- suppliers and direct investors	105,944.3	118,829.4	109,287.9	143,301.2	158,690.0
- other investors	57,185.4	77,772.7	91,393.1	170,082.7	221,528.5
Short-term	345,570.3	314,471.4	359,143.7	344,480.3	353,000.3
by debtor					
- CNB	68.5	44.2	22.8	866.5	5,926.5
- commercial banks	192,438.4	177,474.4	210,017.0	188,495.9	202,540.6
- government	465.0	761.0	710.0	3,334.6	1,102.4
- other sectors	152,598.4	136,191.8	148,393.9	151,783.3	143,430.8
by creditor					
- foreign banks	192,126.4	168,200.7	218,436.1	202,372.6	197,384.4
- multilateral institutions	—	—	—	861.3	5,918.8
- suppliers and direct investors	116,278.4	112,256.8	105,563.9	98,611.3	97,025.0
- other investors	37,165.5	34,013.9	35,143.7	42,635.1	52,672.1
Debt in non-convertible currencies	—	—	—	—	—
of which:					
- long-term	—	—	—	—	—
- short-term	—	—	—	—	—
Total external debt	811,258.1	813,305.2	895,139.6	1,011,807.9	1,125,917.3
of which:					
- long-term	465,687.8	498,833.8	535,995.9	667,327.6	772,917.0
- short-term	345,570.3	314,471.4	359,143.7	344,480.3	353,000.3
Total long-term debt	465,687.8	498,833.8	535,995.9	667,327.6	772,917.0
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	272,202.1	322,318.0
- liabilities of entities with majority private capital	262,585.5	291,508.6	313,875.0	395,125.5	450,599.0

1) Preliminary data

Table 15

EXCHANGE RATES

in CZK; foreign exchange market rates

A. NOMINAL RATE	2002 1 - 12	2003 1 - 12	2004 1 - 12	2005 1 - 12	2006 1 - 3
CZK exchange rate against selected currencies					
- annual/quarterly averages					
1 EUR	30.81	31.84	31.90	29.78	28.60
1 USD	32.74	28.23	25.70	23.95	23.79
100 SKK	72.22	76.75	79.69	77.15	75.36
	12	**12**	**12**	**12**	**3**
- monthly averages					
1 EUR	31.19	32.31	30.65	28.98	28.65
1 USD	30.65	26.32	22.87	24.44	23.83
100 SKK	74.67	78.57	78.81	76.51	76.45
	31 Dec.	**31 Dec.**	**31 Dec.**	**30 Dec.**	**31 Mar.**
- last day of the month					
1 EUR	31.60	32.41	30.47	29.01	28.60
1 USD	30.14	25.65	22.37	24.59	23.62
100 SKK	75.18	78.71	78.63	76.57	75.99

B. NOMINAL EFFECTIVE RATE	2002	2003	2004	2005	2006 3
CZK nominal effective exchange rate (percentages)					
(2000=100)					
weights - foreign trade turnover	116.5	116.0	116.3	123.5	127.6
weights - foreign trade turnover SITC 5-8	116.1	115.6	115.5	122.8	127.1

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	2002	2003	2004	2005	2006 2
CZK real effective exchange rate (percentages)					
(2000=100)					
a) industrial producer prices					
weights - foreign trade turnover	115.2	111.3	114.0	118.9	120.2
weights - foreign trade turnover SITC 5-8	115.9	112.0	115.4	121.1	122.8
b) consumer prices					
weights - foreign trade turnover	116.7	112.9	113.0	118.9	124.4
weights - foreign trade turnover SITC 5-8	117.5	113.7	114.1	120.7	126.7

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

Table 16

PUBLIC FINANCES					in CZK billions
	2002 1 - 12	2003 1 - 12	2004 1 - 12	2005 1 - 12	2006 1 - 3
STATE BUDGET					
Total revenue	705.0	699.7	769.2	866.5	235.9
Tax revenue	627.4	667.5	716.7	770.4	195.7
Taxes on income, profits and capital gains	159.0	172.9	180.7	195.0	46.5
Domestic taxes on goods and services	186.9	198.4	223.2	250.4	66.2
- value-added taxes	118.1	125.6	140.4	146.8	37.6
- excises	68.9	72.9	82.8	103.6	28.7
Taxes on property	7.9	8.8	10.4	8.1	1.9
Social and health security contributions and payroll taxes	258.5	272.4	293.3	311.2	79.0
Non-tax and capital incomes and received subsidies	77.7	32.2	52.5	96.1	40.2
Total expenditure	750.8	808.7	862.9	922.8	220.2
Current expenditure	697.3	745.4	796.8	840.8	210.3
Capital expenditure	53.5	63.3	66.1	82.0	9.9
Public budgets (balance in IMF GFS methodology) [1]	-11.5	-127.7	-90.7	-14.7	__
state budget	-45.7	-104.9	-65.0	-60.5	15.8
local budget	-4.3	-2.9	-8.9	0.5	__
state financial assets	__	__	__	__	__
state funds	12.3	6.9	-13.0	-5.5	__
Land Fund	-0.5	-0.1	0.2	-0.3	__
National Property Fund	28.4	-27.4	-4.2	51.5	__
health insurance companies	-1.2	0.1	0.2	-0.4	__
others	-0.5	0.6	0.0	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	2002 12	2003 12	2004 12	2005 12	2006 3
BCPP					
PX	460.7	659.1	1,032.0	1,473.0	1,523.9
PX-D	1,166.4	1,642.7	2,551.1	3,731.4	__
PX-GLOB	576.8	816.9	1,232.7	1,811.3	1,901.6
RM-SYSTÉM					
PK-30	672.5	947.5	1,443.5	2,365.0	2,495.1

On 20 March 2006, the Prague Stock Exchange's PX 50 and PX-D indices were replaced by a single index called the PX.
Calculation of both the original indices was terminated on Friday, 17 March 2006.
The new main PX index carries on from the PX 50 and takes over its history.

in CZK millions

B. TRADE VOLUMES	2002 12	2003 12	2004 12	2005 12	2006 3
BCPP					
Monthly trade volumes	109,264.8	98,640.0	90,610.5	96,160.5	140,858.9
of which:					
a) shares	17,089.3	28,296.0	46,210.3	56,180.3	81,925.2
b) units	0.0	0.0	0.0	0.0	0.0
c) bonds	92,175.5	70,344.0	44,400.2	39,980.2	58,933.7
RM-SYSTÉM					
Monthly trade volumes	4,412.1	1,103.0	335.8	286.7	234.8
of which:					
a) shares	298.4	1,082.5	332.7	220.9	230.8
b) units	1.0	3.7	3.1	0.0	3.5
c) bonds	4,112.7	16.8	0.0	65.8	0.5

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	—	—
31 October	2.00	1.00	3.00	—	—

Table 19

MACROECONOMIC AGGREGATES

in CZK millions; annual percentage changes; constant 1995 prices

	2001 Q1 - 4	2002 Q1 - 4	2003 Q1 - 4	2004 Q1 - 4	2005 Q1 - 4
Gross domestic product					
- in CZK millions	1,617,894	1,641,996	1,694,684	1,774,184	1,879,790
- percentages	2.6	1.5	3.2	4.7	6.0
Final consumption					
- in CZK millions	1,215,582	1,255,918	1,310,914	1,329,994	1,357,145
- percentages	3.0	3.3	4.4	1.5	2.0
of which:					
Households					
- in CZK millions	851,305	874,649	915,270	945,107	969,804
- percentages	2.8	2.7	4.6	3.3	2.6
Government					
- in CZK millions	355,593	371,673	385,895	375,614	378,559
- percentages	3.8	4.5	3.8	-2.7	0.8
Non-profit institutions					
- in CZK millions	8,793	9,506	9,807	10,915	11,122
- percentages	-12.3	8.1	3.2	11.3	1.9
Gross capital formation					
- in CZK millions	534,349	552,819	559,901	604,291	604,792
- percentages	6.3	3.5	1.3	7.9	0.1
of which:					
Fixed capital					
- in CZK millions	507,629	524,964	549,815	578,984	600,456
- percentages	5.4	3.4	4.7	5.3	3.7
Changes in inventories					
- in CZK millions	26,627	27,731	9,931	25,205	4,198
Acquisitions less disposals of valuables					
- in CZK millions	93	124	155	102	138
- percentages	-43.8	33.0	25.7	-34.2	34.8
Foreign trade					
of which:					
Exports of goods					
- in CZK millions	1,109,034	1,175,324	1,294,538	1,593,388	1,790,958
- percentages	14.4	6.0	10.1	23.1	12.4
Exports of services					
- in CZK millions	192,798	162,181	151,004	167,362	171,197
- percentages	-1.2	-15.9	-6.9	10.8	2.3
Imports of goods					
- in CZK millions	1,244,593	1,302,315	1,418,198	1,698,450	1,798,918
- percentages	14.7	4.6	8.9	19.8	5.9
Imports of services					
- in CZK millions	201,328	214,620	217,569	237,116	229,874
- percentages	3.3	6.6	1.4	9.0	-3.1
Final domestic demand					
- in CZK millions	1,723,211	1,780,882	1,860,729	1,908,978	1,957,601
- percentages	3.7	3.3	4.5	2.6	2.5
Aggregate domestic demand					
- in CZK millions	1,749,931	1,808,737	1,870,815	1,934,285	1,961,937
- percentages	4.0	3.4	3.4	3.4	1.4
Gross domestic product at current prices					
- in CZK millions	2,315,255	2,414,669	2,555,783	2,767,717	2,931,071
- percentages	7.7	4.3	5.8	8.3	5.9

Source: CZSO

Table 20

RATIOS OF KEY INDICATORS TO GDP					percentage ratios
	2001	2002	2003	2004	2005
Public budgets balance	-2.1	-0.5	-5.0	-3.3	-0.5
Public debt	17.5	18.4	21.6	23.8	26.0
Debt in convertible currencies	35.0	33.7	35.0	36.6	38.4
Trade balance [1]	-5.0	-3.0	-2.7	-1.0	1.4
Current account balance	-5.4	-5.6	-6.3	-6.0	-2.1
M2	68.9	68.4	69.1	66.6	68.0
- social benefits other than social transfers in kind	4.6	8.0	3.6	3.6	4.8
- other current transfers	-9.0	4.1	10.9	2.3	6.0
Current expenditure	6.6	8.4	9.5	6.6	6.9
of which:					
- property income	1.7	15.1	21.3	11.7	12.3
- current taxes on income, wealth, etc.	5.9	8.2	12.1	6.3	8.4
- social contributions	6.8	8.9	7.2	7.8	6.8
- other current transfers	8.5	4.7	12.5	0.2	3.7
Gross disposable income	5.3	5.6	4.3	4.7	3.8
Change in net equity of households in pension funds reserves	23.9	22.6	15.4	29.0	9.9
Individual consumption expenditure	6.4	3.5	6.5	5.5	3.6
Gross saving	-4.7	31.8	-15.5	-1.6	7.2
Gross saving rate	7.93	9.90	8.03	7.54	7.79
(gross saving/gross disposable income - ratio in per cent)					

					annual percentage changes
B. AVERAGE WAGES	**2001 Q1 - 4**	**2002 Q1 - 4**	**2003 Q1 - 4**	**2004 Q1 - 4**	**2005 Q1 - 4**
Whole-economy nominal wage	8.1	7.0	6.4	6.2	5.5
Business sector	7.7	6.3	5.5	6.3	5.3
Non-business sector	9.6	9.8	9.8	5.7	6.7
Whole-economy real wage	3.2	5.1	6.3	3.3	3.5
Business sector	2.9	4.4	5.4	3.4	3.3
Non-business sector	4.7	7.9	9.7	2.8	4.7

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 12**
Registered job applicants (thousands)	461.9	514.4	542.4	541.7	510.4
Unemployment rate (percentages)	8.9	9.8	10.3	10.3	__
Unemployment rate (percentages) [1]	__	__	__	9.5	8.9

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

Source: CZSO

Table 21

PRODUCER PRICES

percentage changes

	2002	2003	2004	2005	2006 3
Industrial producer prices					
a) previous month = 100	-0.1	0.1	0.6	0.0	0.1
b) same period of last year = 100	-0.5	-0.3	5.7	3.0	0.3
c) average for 2000 = 100	2.3	1.9	7.7	10.9	11.7
d) December 1999 = 100	5.8	5.4	11.4	14.7	15.5
Construction work prices					
a) previous month = 100	0.2	0.2	0.4	0.2	0.1
b) same period of last year = 100	2.7	2.2	3.7	3.0	2.3
c) average for 2000 = 100	6.9	9.2	13.3	16.6	18.6
d) December 1999 = 100	9.3	11.7	15.8	19.3	21.3
Agricultural producer prices					
b) same period of last year = 100	-9.5	-2.9	8.1	-9.2	0.3
of which:					
crop products					
b) same period of last year = 100	-4.6	-1.0	11.6	-25.0	11.0
livestock products					
b) same period of last year = 100	-12.1	-4.0	6.1	0.4	-4.3
Market services prices					
a) previous month = 100	0.3	0.0	0.2	0.1	0.7
b) same period of last year = 100	3.2	1.6	2.3	1.9	3.8
c) average for 2000 = 100	7.3	9.0	11.5	13.7	17.5
d) December 1999 = 100	8.0	9.7	12.2	14.4	18.2

Source: CZSO

Table 22

RATIOS OF KEY INDICATORS TO GDP					percentage ratios
	2001	2002	2003	2004	2005
Public budgets balance	-2.1	-0.5	-5.0	-3.3	-0.5
Public debt	17.5	18.4	21.6	23.8	26.0
Debt in convertible currencies	35.0	33.7	35.0	36.6	38.4
Trade balance [1)]	-5.0	-3.0	-2.7	-1.0	1.4
Current account balance	-5.4	-5.6	-6.3	-6.0	-2.1
M2	68.9	68.4	69.1	66.6	68.0

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

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