INFLATION REPORT / JANUARY

2006

CNB CZECH NATIONAL BANK

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ABBREVIATIONS USED

BCPP	Prague Stock Exchange
CHF	Swiss franc
CNB	Czech National Bank
CPI	consumer price index
ČSOB	Československá obchodní banka
CZK	Czech koruna
CZSO	Czech Statistical Office
ECB	European Central Bank
EIB	European Investment Bank
EMU	Economic and Monetary Union
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 (see section III.1.1.)
MD	Ministry of Defence
MF	Ministry of Finance
MI	Ministry of the Interior
NBS	National Bank of Slovakia
NCG	net credit to government
NDAs	net domestic assets
NEAs	net external assets
NPISHs	non-profit institutions serving households
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
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.

The annex to the January Inflation Report is a document that analyses the current and expected fulfilment of the Maastricht criteria and the degree of economic alignment of the Czech Republic with the euro area. Based on these analyses, it recommends that the Czech Government should not attempt to enter the ERM II during 2006. The document was drawn up by the Ministry of Finance of the Czech Republic, the Ministry of Industry and Trade of the Czech Republic and the Czech National Bank, and was approved by the Government of the Czech Republic on 23 November 2005.

This Inflation Report was approved by the CNB Bank Board on 2 February 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 in the lower half of the target band in 2005 Q4
(annual percentage changes in CPI)

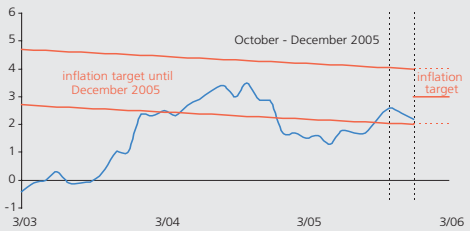


Table I.1
Inflation declined in the last two months of 2005 Q4
(annual percentage changes unless otherwise indicated)

	09/05	10/05	11/05	12/05
Consumer price inflation	2.2	2.6	2.4	2.2
Industrial producer price inflation	1.0	0.3	0.0	-0.3
Money supply growth (M2)	4.2	5.0	6.8	-
3M PRIBOR[a] (in per cent)	1.8	1.9	2.2	2.2
Nominal CZK/EUR exchange rate[a] (level)	29.31	29.68	29.26	28.98
State budget balance since January incl. SFAOs[b] (CZK bn)	25.8	15.2	0.2	-56.4
GDP growth at constant prices[c]	4.9			-
Unemployment rate[b] (in per cent)	8.8	8.5	8.4	8.9

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

Consumer price inflation fell in the final two months of 2005 Q4, but remained within the target band, fluctuating in the lower half thereof (see Chart I.1). The growth of the Czech economy slackened slightly in 2005 Q3, but was still around the 5% level. The labour market in 2005 Q3 saw a continuing recovery in labour demand, although this led to only a modest decline in the unemployment rate. Market interest rates rose in 2005 Q4, and the koruna-euro exchange rate appreciated in the final two months of Q4.

After rising in October, annual consumer price inflation gradually slowed in the subsequent months of Q4. The main factors behind the October inflation increase were rises in natural gas prices and television and radio licence fees. The decline in November and December was chiefly caused by a sharp slowdown in fuel prices. Underlying this were changes in oil prices on world markets and in the profit margins of producers and sellers in the fuel industry. Other contributing factors included a December decline in food prices, caused by falling agricultural producer prices and imported food prices, and a fall in prices of other tradable commodities resulting from declining import prices.

According to a preliminary CZSO estimate, GDP growth eased to just below the 5% level in Q3. The modest slowdown in the rate of growth of the Czech economy was due to a decrease in the contribution of net exports of approximately one-third compared to the previous quarter. Nevertheless, the external sector continued to account for most of the economic growth. The decline in the growth contribution of net exports was offset to a large extent by an increase in the contribution of aggregate domestic demand, which had been flat in H1. With the exception of inventories, all components of domestic demand (household consumption, investment demand and government consumption) contributed to its upturn in Q3.

The continuing buoyant growth of the Czech economy led to an upswing in employment growth and a moderate decrease in the unemployment rate. However, the cyclical component of registered unemployment did not decline to the extent corresponding to the changes in employment. As in the previous quarter, corporations' growing demand for labour was not reflected in nominal wages in the business sector. Their year-on-year growth picked up only slightly in Q3 and remained much lower than a year earlier. By contrast, growth in nominal wages in the non-business sector was considerably faster than in Q2. The reason for this was that the effect of the January rise in wages and salaries in selected professions exceeded that of the abolition of the "thirteenth" and "fourteenth" paycheques.

The money market in 2005 Q4 saw a rise in interest rates at all maturities, reflecting the October increase in monetary policy rates and expectations of their growth in the period ahead. From around mid-November, interest rates partly corrected their previous growth as a result of the appreciating koruna and the lower-than-expected November inflation outturn. The koruna's exchange rate against both the main currencies weakened during October, but the trend changed in November and the koruna started appreciating against the euro and later also against the dollar. The koruna's exchange rate was affected by investors' sentiment about the Central European region, the dollar-euro exchange rate and the actual and expected changes in interest rates in the Czech Republic and the euro area.

The monetary policy decision-making of the CNB Bank Board in 2005 Q4 was based on the inflation forecast discussed by the Board at its meeting on 27 October 2005 and published in the October Inflation Report. Given the monetary policy transmission lag, the Board focused on hitting the inflation target in October 2006 – March 2007. According to the forecast, inflation should be just above the point inflation target in this period. Consistent with the baseline scenario was a gradual rise in interest rates.

At its meeting at the end of October, the Bank Board decided by a majority vote to raise the monetary policy interest rates by 0.25 percentage point with effect from 31 October 2005. Its decision was consistent with the forecast and was also supported by the fact that the Bank Board had not identified any significant asymmetric risk to the forecast. The main areas discussed included the second-round effects of the growth in energy prices, the pass-through of the growth in prices to wages and the effect of fiscal policy in the following year. In November, the Bank Board assessed the risks of the forecast as roughly balanced. In December, it assessed them as being on the downside and left interest rates unchanged.

Section IV of this Inflation Report describes the CNB's new forecast. The January forecast somewhat changes the view regarding the output gap going forward, predicting a more modest widening in 2006 and closure as early as the first half of 2007. Nonetheless, owing to the anti-inflationary effects of the nominal exchange rate and a revision of the impacts of the changes to excise duties on cigarettes and the future fuel price inflation path, the inflation forecast for the short-term horizon has been revised downwards. Decreasing anti-inflationary pressures from the real economy accompanied by rising regulated prices and further changes to indirect taxes will gradually prevail, resulting in an expected rise in inflation in 2007. At the monetary policy horizon, the inflation forecast is close to the point inflation target.

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 and is close to 3% at the end of 2007. Consistent with the January forecast is a gradual rise in interest rates, albeit to a lesser extent than assumed in the previous forecast. However, the current exchange rate developments and exchange rate expectations deviate from the forecasted trajectory. Overall, this shifts the risks of the forecast in an anti-inflationary direction. Sensitivity analyses have been performed showing that monetary policy can respond to a stronger koruna exchange rate with a decline in interest rates.

The January forecast reassessed the evolution of equilibrium variables, in particular equilibrium real interest rates and the equilibrium real appreciation of the exchange rate. Given the uncertainty associated with estimating these variables, an alternative scenario was drawn up during the preparation of the January forecast. This preserves the paths of the equilibrium variables from the October forecast. It results in a slightly lower inflation forecast and in a gradually rising interest rate path that is somewhat steeper than in the baseline scenario.

The annex to this Inflation Report is the full version of the *Assessment of the Fulfilment of the Maastricht Convergence Criteria and the Degree of Alignment of the Czech Economy with the Euro Area*. This document, which the CNB was involved in preparing, was approved by the Government of the Czech Republic on 23 November 2005. The aim of the document is to inform the Government about the current and expected fulfilment of the Maastricht criteria and the degree of alignment of the Czech economy with the euro area economy. In accordance with *The Czech Republic's Euro-area Accession Strategy* (see the October 2003 Inflation Report), the Minister of Finance – assisted by the Governor of the CNB and the Minister of Industry and Trade – is required to submit such a document to the Government every year. The document recommends that the Czech Government should not attempt to enter the ERM II during 2006.

CHART I.2
The inflation forecast is near the point inflation target at the monetary policy horizon
(annual percentage changes in CPI)

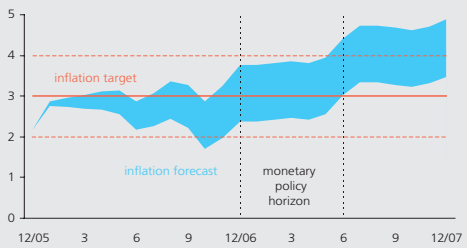


CHART I.3
Excluding the first-round impacts of indirect taxes, the forecast is just below the point inflation target at the monetary policy horizon
(annual percentage changes)

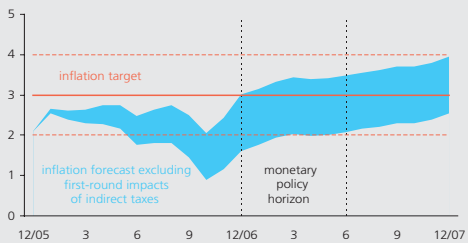


Chart II.1
The inflation rate fell in 2005 Q4
(percentages)

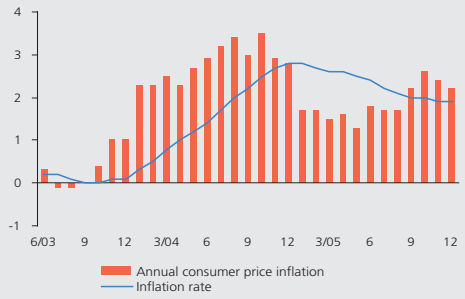


Table II.1
Consumer prices showed mixed structural developments
(annual percentage changes)

	7/05	8/05	9/05	10/05	11/05	12/05
Consumer prices	1.7	1.7	2.2	2.6	2.4	2.2
Food and non-alcoholic beverages	-0.7	-0.8	-0.3	0.3	0.4	-0.9
Alcoholic beverages and tobacco	0.2	0.0	0.0	0.2	0.2	0.7
Clothing and footwear	-5.1	-5.5	-5.7	-6.2	-6.3	-6.6
Housing, water, electricity, gas and other fuels	4.1	4.1	4.1	5.1	5.1	5.1
Furnishings, household equipment and routine maintenance of the house	-2.0	-1.9	-2.0	-1.9	-1.8	-1.8
Health	7.7	7.6	7.6	7.4	7.4	7.4
Transport	2.1	2.2	6.8	5.6	4.2	3.6
Communication	14.6	16.1	15.6	14.0	14.0	14.1
Recreation and culture	0.8	0.9	1.1	2.6	2.4	2.4
Education	2.5	2.5	1.4	1.8	1.8	1.8
Hotels and restaurants	3.0	2.9	3.0	2.9	2.8	2.7
Miscellaneous goods and services	0.2	0.2	0.4	0.6	0.5	0.5

Chart II.2
Regulated prices accounted for most of the inflation recorded in 2005 Q4
(percentages)

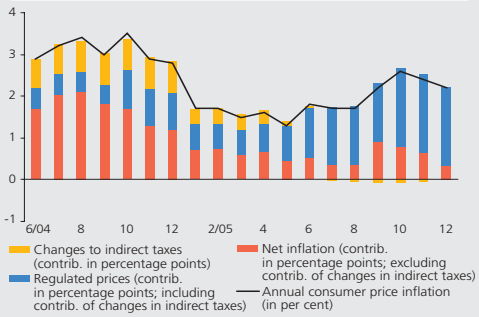
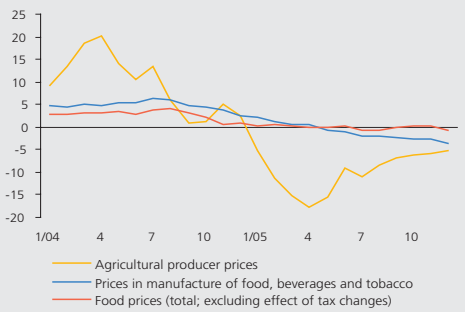


Chart II.3
Food prices were falling year on year at the end of 2005
(annual percentage changes)



II.1 PAST INFLATION DEVELOPMENTS

Inflation[1] was uneven during the course of Q4. In October it rose by 0.4 percentage point to 2.6%, but over the following two months it gradually decreased to the September level in year-on-year terms (reaching 2.2% in December). The inflation rate[2] fell slightly in 2005 Q4 to stand at 1.9% in December.

Although annual inflation recorded the same values at the close of 2005 as at the end of Q3, the price developments within the consumer basket categories indicated some contrary changes during Q4. In particular, annual inflation increased in the category of "Housing, water, electricity and fuels", owing to pass-through of the rapidly growing prices of natural gas on world markets to domestic prices. Conversely, some other categories of the consumer basket saw slowing growth or a deepening decline in prices in Q4. This was particularly visible in transport, where a significant slowdown in price growth reflected a relatively fast fall in the rate of growth of oil prices on world markets and the evolution of margins in fuel production and sale. A deepening decline in food prices also contributed significantly to the slower growth in consumer prices in December. Overall, these price movements generated a sharp pick-up in annual growth in regulated prices and slower growth in market prices.

The effect of the still relatively fast growing prices of imported energy-producing commodities was thus mixed and gradually weakened during Q4. High natural gas import prices strongly affected consumer prices in October with a lag. This factor caused regulated prices to be the main component of the 2.2% consumer price growth at the end of 2005 (see Chart II.2). Growth in world oil prices, unlike natural gas prices, slowed markedly and subsequently fostered a decline in annual industrial producer price inflation. As in the previous quarter, their stronger effect on producer prices was visible only at the first stages of the product vertical. Falling prices of most other imported inputs year on year also contributed to the weakening of external cost pressures. The personnel cost-output ratio in industry also developed favourably with regard to inflation, as nominal unit wage costs decreased in year-on-year terms.

Although economic growth remained buoyant in 2005 Q3, by the CNB's estimation the economy had still not reached its potential, non-accelerating inflation level of output. Consumer demand growth was not high, and competition remained strong on the retail market amid excess supply. As in the previous quarters, inflation was also counteracted by foreign competition, which acted via mostly falling prices of imports of final products. Under these circumstances, the faster growing prices of imported and some domestic energy sources[3] passed through significantly to consumer prices only in the categories of fuels and housing.

Overall, the aforementioned demand and supply-side factors fostered a reduction in the growth of market prices as measured by net inflation.[4] Their year-on-year growth moderated by 0.7 percentage point compared to the end of 2005 Q3 to stand at 0.4% in December. The decline in annual market price inflation was due both to food prices and to prices of non-food commodities.

[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] In particular electricity for the corporate sector.
[4] Net inflation = consumer price inflation net of regulated prices and adjusted for other administrative measures.

Food prices, which usually fluctuate more, recorded a modest year-on-year rise in October and November, after declining in September. In December, however, they showed another year-on-year decline, this time of 0.7%.[5] Food prices were affected throughout 2005 by falling agricultural producer prices and food import prices. Alcoholic beverages were the only category to show a greater positive contribution to the year-on-year change in food prices at the year-end. The increase in excise duties on cigarettes and tobacco products as from 1 July 2005 has not yet passed through into food prices. Stocks are currently being sold off at their original price and moreover the producers of cigarettes, represented in the consumer basket, have offset the tax adjustments by decreasing their profit margins.

Prices of non-food commodities[6] were also mixed in Q4. The year-on-year decline in prices of tradable commodities except fuels, which are significantly affected by the external competitive environment, continued into 2005 Q4. This decline moderated slightly compared to the end of Q3, amounting to 2.3% in December. The causes of the long-term decline in prices of these commodities remain the same as described in previous Inflation Reports, namely the year-on-year appreciation of the koruna's exchange rate combined with the low prices of many consumer products on foreign markets and tough price competition on the domestic market. A long-running decline in prices has been recorded in the categories of clothing and footwear and household equipment and furnishing in particular.

Prices of nontradable commodities, which consist primarily of domestic services, continued rising in Q4 (by 2.2% in December). Chart II.4 shows that the rate of price growth in this group has been gradually easing since 2004 Q4. This trend corresponds mainly to the low level of domestic demand, the subdued growth in wage costs and the relatively low inflation expectations throughout this year. Prices in the categories of health, recreation and culture and hotels and restaurants contributed most to the growth in prices in this group at the end of 2005.

Among the non-food commodities, fuel prices showed the fastest growth again in 2005 Q4. They remained very volatile, responding to the oil price movements on world markets. Following a large year-on-year increase to 21.6% in September, the fuel price growth moderated during Q4 to stand at 9.8% in December. This pronounced decline in growth was associated with a marked slowdown in oil prices on world markets. But fuel prices fell faster than would correspond to the decline in oil prices and the development of the koruna-dollar exchange rate. However, it will only be possible to analyse the causes of this situation on the basis of further developments.

Regulated prices also increased very fast in 2005 Q4. Their significant increase – of 2.2 percentage points to 9.0% compared to the end of 2005 Q3 – was mainly the result of a rise in prices of natural gas for households with effect from 1 October 2005 (of 17.4% year on year). TV and radio licence fees and heat prices were also raised. Other regulated items saw only minor movements with minimal impacts on inflation.

Turning to international comparisons, annual consumer price inflation in the Czech Republic, as measured by the harmonised index of consumer prices (HICP), was below the inflation level in the EU in the first three quarters of 2005. In October, however, this situation changed and inflation in the Czech Republic was slightly higher than in the EU countries, owing to the marked increase in regulated prices. In November, inflation in the EU countries and the Czech Republic converged to the

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

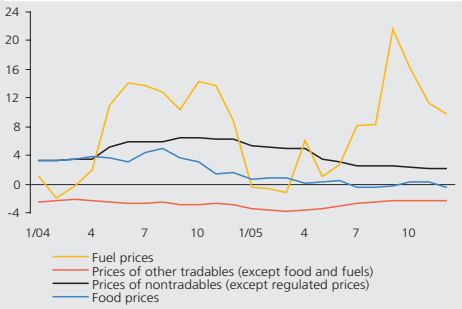


Chart II.5
The faster growth in regulated prices was due primarily to rising natural gas prices
(annual percentage changes)

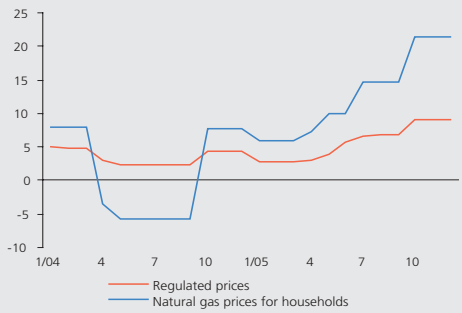
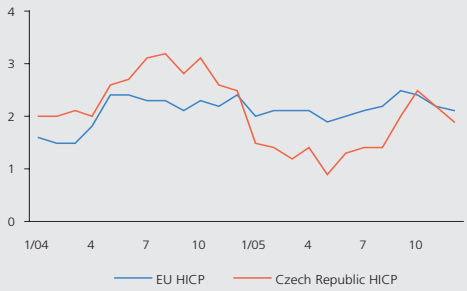


Chart II.6
Consumer price inflation was lower in the Czech Republic than in the EU countries in December
(annual percentage changes)



[5] Consolidated category of food, non-alcoholic beverages, alcoholic beverages and tobacco.
[6] Non-food commodity prices = tradable commodity prices + nontradable commodity prices + fuel prices.

same figure of 2.2%. According to the latest figures for December, HICP growth in the Czech Republic fell to 1.9% and was again lower than in the EU countries, where it stood at 2.1%.

II.2 FULFILMENT OF THE INFLATION TARGET

Actual inflation returned to the CNB's target band in 2005 Q4 (see Chart I.1). This section of the Inflation Report briefly analyses the contribution of the CNB's monetary policy to this situation.

Changes to interest rates pass through into inflation most strongly with a lag of around 12 to 18 months. Accordingly, to assess the effect of monetary policy on the fulfilment of the inflation target in 2005 Q4, one needs to analyse retrospectively the forecasts, and the Bank Board's decisions based thereon, dating from around April to December 2004. For comprehensibility, the analysis of the accuracy of the forecasts is limited here to a comparison of the forecast drawn up in July 2004, i.e. approximately in the middle of the aforementioned period, with inflation in 2005 Q4 (see Table II.2).

The July 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 to join the inflationary effect of the closing output gap. Overall, the July forecast predicted that inflation would be roughly at the centre of the target band over the entire forecast horizon. Actual inflation corresponded to this forecast in 2004, but in 2005 it deviated downwards (see Chart II.7). A closer look at the inflation structure reveals that adjusted inflation excluding fuels, growth in food prices and changes to indirect taxes in 2005 Q4 were considerably lower than the forecast. By contrast, growth in regulated prices and fuel prices was higher than forecasted.

The lower consumer price inflation in 2005 Q4 than forecasted in July 2004 can be put down, *inter alia*, to factors lying partly or completely outside the purview of the CNB's monetary policy. The factors acting towards lower inflation included lower external demand and foreign interest rates, lower agricultural producer prices and a smaller fiscal impulse relative to the forecast, and the postponement of changes to indirect taxes. The anti-inflationary effect of these factors was only partly offset by the higher price of oil and the related higher external inflation (see Table II.3) and by higher growth in regulated prices in the final quarter of 2005.

Consistent with the July forecast was a gradual rise in interest rates. The actual interest rate path was roughly at the forecast level in 2004, but was well below the forecast in 2005. Interest rates were raised by 0.25 percentage point in August 2004 and then cut three times during 2005 H1. They were raised again in October 2005. In the key period as regards the most recent consumer price developments, i.e. in the final three quarters of 2004, nominal interest rates were broadly in line with the forecast. However, interest rates in real terms were slightly tighter than forecasted. The nominal koruna-euro exchange rate was stronger than forecasted, although an upward revision of the rate of real equilibrium appreciation meant that the effect of the real exchange rate was easier. Overall, then, the monetary policy effect was in line with the assumptions of the July 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

Table II.2
Headline inflation in 2005 Q4 was lower than forecasted in July 2004
(annual percentage changes; contributions in percentage points)

	July 2004 forecast	2005 Q4 outturn	Contributionto total difference in perc. points [a]
Annual consumer price inflation	3.0	2.4	-0.6
Breakdown into contributions:			
regulated prices	2.6	9.0	1.3
indirect taxes	0.5	0.0	-0.5
food prices, excluding changes to indirect taxes	1.6	0.0	-0.4
fuel prices, excluding changes to indirect taxes	-0.5	12.4	0.2
adjusted inflation excluding fuels, excluding changes to indirect taxes	3.1	0.5	-1.3

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

Chart II.7
Actual inflation deviated from the forecast in 2005
(annual percentage changes)

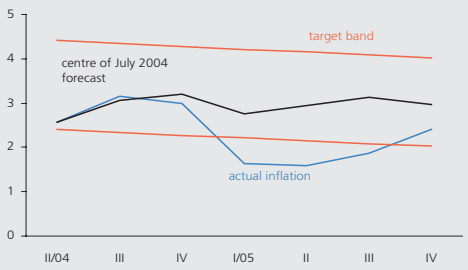


Table II.3
Of the exogenous factors, external demand, interest rates and the price of oil deviated the most from the forecasts

		III/04	IV/04	I/05	II/05	III/05	IV/05
GDP Germany [a]	prediction	1.6	1.9	1.4	1.8	1.8	1.8
(annual perc. changes)	outturn	1.2	1.3	0.3	0.8	1.3	-
CPI in Germany	prediction	1.5	1.6	1.4	1.0	1.4	1.4
(annual perc. changes)	outturn	1.9	1.9	1.7	1.7	2.1	2.2
1Y EURIBOR	prediction	2.4	2.5	2.7	2.9	3.0	3.2
(percentages)	outturn	2.3	2.3	2.3	2.2	2.2	2.6
USD/EUR exchange rate	prediction	1.22	1.22	1.22	1.23	1.22	1.21
(levels)	outturn	1.22	1.30	1.31	1.26	1.22	1.19
Oil prices [b]	prediction	30.9	29.4	28.3	27.8	27.7	27.8
(USD/barrel)	outturn	38.0	37.3	42.8	47.6	57.3	53.3

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

forecast was prepared. The only change made to the forecasting system since July 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 July 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 July 2004. Overall, these revisions have not markedly changed the CNB's view of the output gap going forward. Nevertheless, they have led to an increase in the estimated growth of potential output by more than one percentage point.

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 July forecast was drawn up can be briefly interpreted in the following way.

A combination of a smaller fiscal impulse and lower external demand led to slower-than-forecasted closure of the output gap. The wider output gap manifested itself in lower growth in adjusted inflation excluding fuels. This, coupled with lower food prices as a result of the above-average harvest in 2004 and 2005, faster-than-expected appreciation of the koruna's exchange rate due to lower foreign rates, and with the postponement of changes to indirect taxes, led to lower-than-forecasted overall inflation at the end of 2005.

The inflation forecast is the primary source material for the Bank Board's decisions. Also of key importance is an assessment of the possible risks associated with this forecast by the board members. At the Board's meetings during the final three quarters of 2004 (see the relevant minutes), the overall perception of the risks was slightly anti-inflationary (the April forecast anti-inflationary, and the July and October forecasts roughly neutral). Although this anti-inflationary perception of the risks was not sufficient for the Bank Board to deviate from the recommendations of the forecast, communication of the risks of the forecasts and the postponement of changes to interest rates to later months helped to smooth the interest rate path. One can say with the benefit of hindsight that the anti-inflationary risks materialised to a greater extent, hence monetary policy could have been easier in the key period. This fact also contributed to the fulfilment of the inflation target in its lower half in 2005 Q4.

Table II.4

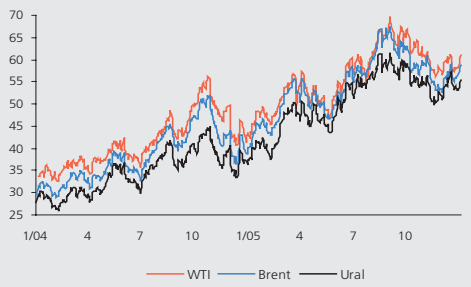
Tighter fiscal policy and lower external demand relative to the forecast led to slower closure of the output gap

		III/04	IV/04	I/05	II/05	III/05	IV/05
3M PRIBOR	prediction	2.4	2.6	2.8	3.1	3.4	3.8
(percentages)	outturn	2.6	2.6	2.3	1.9	1.8	2.1
CZK/EUR exchange rate	prediction	31.8	31.8	31.7	31.6	31.4	31.1
(levels)	outturn	31.6	31.1	30.0	30.1	29.7	29.3
GDP	prediction	4.2	4.3	4.0	4.2	4.1	4.7
(real, annual perc. changes)	outturn	4.9	5.0	5.0	5.2	4.9	-
Output gap	prediction	-0.6	-0.2	0.2	0.5	0.7	0.9
(percentages of GDP)	outturn*	-1.1	-0.8	-0.5	-0.4	-0.3	-0.1

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

III.1 THE EXTERNAL ENVIRONMENT

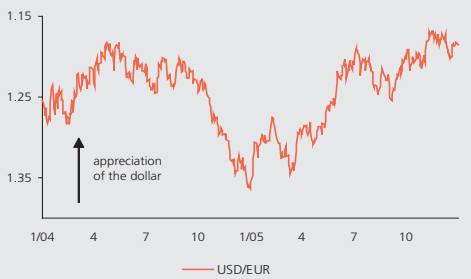
Chart III.1
The average price of WTI crude oil fell by almost 5% in Q4 compared to Q3
(USD/barrel)



The external environment in 2005 Q3 created favourable conditions for growth of the Czech economy. The United States continued to record robust economic growth in 2005 Q3. Although the pace of growth in the euro area was much weaker, the recovery there gained momentum. GDP growth in the countries of the Central European region accelerated, with Slovakia remaining the fastest growing economy in the region. In Q4, the US dollar appreciated against the euro to its strongest level in two years. Oil prices in this period fell from their record levels recorded in Q3. The price of US WTI crude oil fluctuated around USD 60 per barrel, the average level being 5% lower than in Q3.

At 3.6%, annual GDP growth in the USA remained as strong in 2005 Q3 as in the previous two quarters. The aftermath of hurricanes Katrina and Rita seems to have been quickly overcome. The growth was due to a large rise in domestic demand, particularly household consumption and fixed investment. The deficit on goods and services further deteriorated in October, to a record USD 69 billion. Compared to Q2, the current account deficit improved by USD 2 billion to USD 196 billion in Q3, but this figure still represents a considerable increase in the external imbalance by comparison with the previous year. Industrial production saw year-on-year growth of 3% in November, and capacity utilisation also increased significantly. The unemployment rate decreased to 4.9% in December, remaining close to the 5% level for the tenth consecutive month.

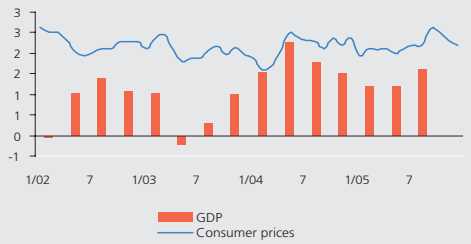
Chart III.2
In December the dollar appreciated to USD 1.167/EUR, its highest level in two years



Consumer price inflation, which recorded a steep increase after the hurricanes in September, is gradually returning to its previous levels, falling from 3.5% in November to 3.4% in December. The Fed reacted to the strong economic growth, low unemployment and inflationary pressures generated by energy prices by twice raising its key rate by 0.25 percentage point in Q4, to 4.25%.

Annual economic growth in the euro area increased by 0.4 percentage point to 1.6% in 2005 Q3. The growth was less than half that in the USA, but ever more signals are emerging indicating a reversal in trend after a period of low growth and high unemployment, with the previously weak recovery gaining momentum. In Q3, higher increases were recorded in particular for fixed investment. Private and government consumption saw only a modest pick-up, with their growth rate remaining low. Exports grew faster than imports, leading to an improvement in net exports. This period also saw a narrowing of the current account deficit, from EUR 13 billion in the previous quarter to EUR 5 billion. Industrial production growth increased by 0.7 percentage point to 1.3% in Q3. In November, the unemployment rate remained flat at 8.3% for the third consecutive month, falling by 0.5 percentage point by comparison with November 2004.

Chart III.3
Economic growth in the euro area picked up in 2005 Q3 after four quarters of decline
(annual percentage changes)



Annual consumer price inflation slowed to 2.2% in December. Following the September rise to 2.6% caused by higher energy prices, this was the third month-on-month decrease in consumer price inflation. Producer price inflation showed a similar trend, decreasing to 4.2% in November. Core inflation remained unchanged in this period at around 1.3%. The stronger economic growth, weaker euro and higher energy prices generated a rise in inflationary pressures, which the ECB responded to on 1 December 2005 by raising its key rate for the first time in five years, by 0.25 percentage point to 2.25%.

There are ever more signals in Germany indicating a recovery in the previously almost stagnating economy. Seasonally adjusted annual GDP growth was 1.4% in 2005 Q3, which is double the Q2 figure. This growth was due to a rise in fixed investment, which picked up slightly after numerous quarters of year-on-year decline, and in particular to greatly improved net exports. Household consumption and government consumption were both flat. Despite the improvement in Q3,

economic growth remained below the average euro area level. The export growth was associated with growth in industrial production, which was up by almost 5% in November. By contrast, owing to the flat consumption, retail trade turnover actually decreased in November, after stagnating in September and October. The strengthening recovery was also confirmed by an unexpected decrease in the unemployment rate from 11.4% in October to 11.2% in December. This was the third decrease in a row and was accompanied by a rise in the number of job vacancies. Thanks to falling energy prices, consumer price inflation decreased further in December, to 2.1%.

Economic growth in the countries of the Central European region increased in Q3. The only exception was Hungary, which "merely" maintained the high rate of growth it recorded in the previous quarter. Economic growth in Slovakia was again the strongest. The lowest consumer and producer price inflation was achieved in Poland.

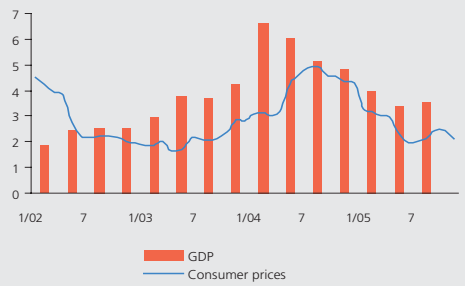
Annual GDP growth in Hungary remained at 4.5% in 2005 Q3. This outcome was achieved thanks to buoyant investment growth, despite a deterioration in net exports. The economic recovery in the euro area in the second half of last year helped the Hungarian economy to improve its annual trade balance. According to preliminary data, the 2005 trade deficit narrowed by more than one percentage point compared to 2004, to 3.2% of GDP. Industrial production increased by almost 10% in October and retail trade turnover was up by about 7% in September and October. Despite these positive results, at 7.2% unemployment was only 0.1 percentage point lower in November than in October, and about 1 percentage point higher than a year earlier. In November, consumer price inflation picked up slightly, to 3.3%, as did producer price inflation, to 4.4%. The Hungarian central bank has left its key rate unchanged at 6% since mid-September. The state budget ended 2005 with a lower-than-approved deficit of 4.4% of GDP. Fitch Ratings downgraded the Hungary's foreign currency rating owing to its high current account and state budget deficits.

Despite rising by almost one percentage point to 3.7% in 2005 Q3, Poland's economic growth was the slowest in the Central European region. Up until Q2, the growth had been driven solely by exports, and only in Q3 was there a renewed increase in domestic demand, with household consumption growth rising to 3% and investment growth to almost 6%. The economic recovery also manifested itself in a rise in growth in industrial production in October (to almost 8%) and retail trade turnover in November (to 10%). Poland's registered unemployment rate, the highest in the EU, was the same in November as in October, but in year-on-year comparison it decreased by 1.4 percentage points, to 17.3%.

Thanks to lower energy prices, a stronger zloty and low domestic inflationary pressures, consumer price inflation fell from 1.6% in October to 1% in November. Poland's inflation thus fell below the EU average. For the same reasons, annual producer price inflation was negative for the fourth consecutive month. Core inflation stood at only 1.2% in October. Because of political uncertainty and rising wages and retail trade turnover at the end of last year, the Polish central bank's Monetary Policy Committee left the key rate unchanged at 4.5%.

Economic growth in Slovakia increased to 6.2% in 2005 Q3, up by more than one percentage point compared to Q2. The robust growth – the strongest in the Central European region – was mainly due to rapidly growing investment and improving net exports, together with a strong increase in household consumption facilitated by high real wage growth and rising employment. It was also reflected in a 10% rise in retail trade turnover in November, following even higher increases in September and October. The dynamic economic growth fostered an almost two-point reduction in the annual unemployment rate, which reached 10.9% in November and was the same as in October. In spite of falling energy prices that month, consumer price inflation rose to 3.4% as a result of rising food prices. Core inflation remained low, however.

Chart III.4
In the "new" EU Member States, GDP growth stopped declining and inflation fell again at the end of 2005
(annual percentage changes)



Slovakia made a significant step towards adopting the euro. At the end of November, the EU finance ministers approved its joining the ERM II with an exchange rate of SKK 38.455/EUR and a fluctuation band of +15%. The NBS did not react to the higher consumer and producer price inflation and left its key rate unchanged for the tenth consecutive month. Thanks to higher-than-planned revenues and lower expenditure, the Slovak state budget ended 2005 with a deficit of SKK 34 billion, instead of the SKK 62 billion approved by parliament. This meant that the deficit as a percentage of GDP was very close to the 3% Maastricht budget criterion.

III.2 THE MONETARY CONDITIONS

According to the CNB's calculations, the settings of the real monetary conditions in 2005 Q4 can broadly be characterised as neutral to slightly easy. The interest rate and exchange rate components can both be assessed in the same way.[7] Their evolution in 2005 Q4 is described in more detail below.

III.2.1 Interest rates

Interest rates increased at all maturities in 2005 Q4. The main reason for this was a 0.25 percentage point rise in the CNB's key rates introduced with effect from 31 October 2005. The 2W repo rate was set at 2%, the Lombard rate at 3% and the discount rate at 1%.

Interest rates had reached historical lows roughly in mid-2005. However, most financial market participants had gradually come to agree that the period of rate cuts was over and that the next change to the CNB's key rates would be upwards. The initially modest rate increases accelerated after the CNB tightened monetary policy at the end of October. Developments on foreign financial markets also played a role. In the euro area, expectations regarding an increase in key interest rates rose, while in the USA the key rate has been regularly raised since mid-2004. At the end of 2005, domestic rates partly corrected their previous growth. The financial market started to speculate on a slower pace of increase in the CNB's key rates. The main reasons for this were the appreciating exchange rate of the koruna, which was tightening the overall monetary conditions, and also the lower-than-expected inflation figures. Nonetheless, PRIBOR spot quotations and FRA forward quotations at the end of 2005 indicated that the majority of the financial market expected a further monetary policy tightening to occur in 2006 Q1.

The PRIBOR yield curve gradually shifted to a higher yield level and its positive slope increased at the same time. The spread between the 1Y PRIBOR and the 2W PRIBOR was 0.49 percentage point in December. By contrast, the slope of the IRS yield curve decreased thanks to higher growth in rates at its shorter end. In December, the average 5Y-1Y spread was 0.69 percentage point and the 10Y-1Y spread 1.02 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 increased its key O/N rate to 4.25% and the ECB raised its refinancing operations

CHART III.5
The CNB raised its key interest rates
(percentages)

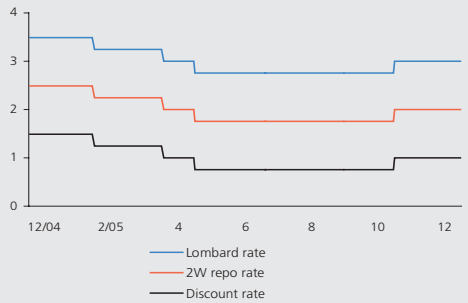


CHART III.6
Market interest rates increased
(percentages)

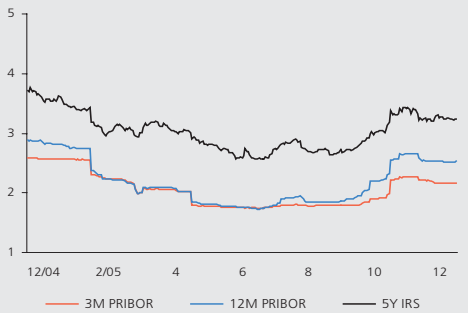
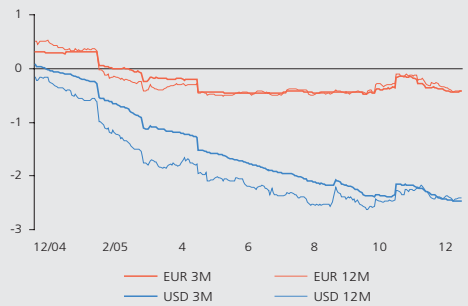


CHART III.7
The interest rate differentials of the koruna vis-à-vis the euro and the dollar fluctuated in negative values
(percentage points)



[7] 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.

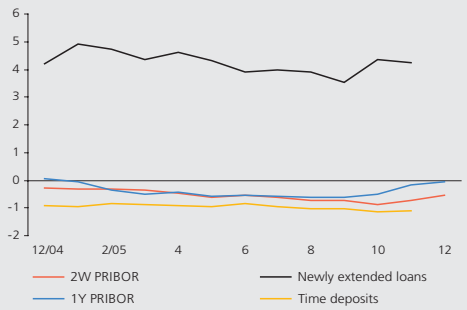
rate to 2.25%. The interest rate differential vis-à-vis euro and dollar rates was negative at all maturities.

Five auctions were held on the primary government bond market, with original maturities of 3Y–15Y and a total volume of CZK 31.2 billion. All auctions met with sufficient interest, and the results were mostly in line with expectations. Standard & Poor's upgraded the Czech Republic's rating outlook from stable to positive. At the same time it confirmed the existing long-term foreign currency rating at A-; the short-term rating remains A-2.

The evolution of interest rates on the financial market is also reflected in client interest rates. Nominal interest rates on new loans were 5.4% in November, down by 0.7 percentage point since the start of the year. Rates on new time deposits were 1.7%. The interest rate margin between the overall loan and deposit rates is not subject to sizeable fluctuations; it has been flat at 4.5 percentage points since mid-2005.

Real interest rates[8] 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 4.2% in November, while real rates on time deposits were -1.1%.

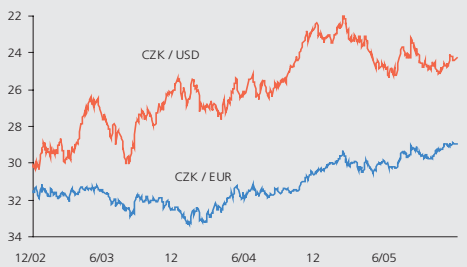
CHART III.8
Ex ante real interest rates on new loans remained above 4%
(percentages)



III.2.2 The exchange rate

The average exchange rate of the koruna against the euro was CZK 29.3/EUR in 2005 Q4, which represents a year-on-year appreciation of 5.8% (and a quarter-on-quarter appreciation of 1.4%). The appreciation trend, which started in 2004 Q2, thus continued. Besides the favourable evolution of economic fundamentals (rapid economic growth accompanied by low inflation and a sharply improving trade balance), the exchange rate was affected by foreign short-term investors' positive view of the Central European region. Investors' interest in the individual countries of the region was still quite mixed. The koruna's appreciation was again weaker than the zloty's, but stronger than the forint's. The strong appreciation of the koruna during November (of more than 2%) was probably also fostered by the 0.25 percentage point rise in monetary policy rates in the Czech Republic at the end of October, coupled with short-term investors' expectations regarding further growth in those rates. In December, probably owing to the rate increase in the EMU (of 0.25 percentage point) and the gradual revision of short-term investors' expectations regarding domestic rates, the koruna's appreciation came to a halt. The appreciation of the koruna occurred amid a slightly negative/zero interest rate differential against the euro and a relatively pronounced and, moreover, increasing negative differential against the dollar.

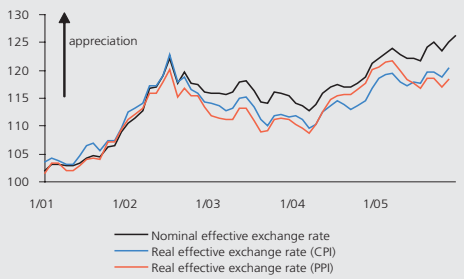
CHART III.9
The koruna appreciated against the euro in 2005 Q4



In 2005 Q4, the average exchange rate of the koruna against the dollar was CZK 24.6/USD, which represents a year-on-year depreciation of 2% (and a quarter-on-quarter depreciation of about 1.2%). This change in trend (in Q3 the koruna showed 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 and then started to appreciate (between March and November 2005). This 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 and the temporarily more advantageous repatriation of profits.

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

Chart III.10
The nominal effective exchange rate continued to show year-on-year growth in 2005 Q4
(year 2000 = 100)



The nominal effective exchange rate of the koruna appreciated by 4.7% year on year in 2005 Q4 (but by only 4.0% in December 2005), 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. Compared to the previous quarter, the year-on-year appreciation of the koruna's nominal effective exchange rate again slackened slightly, mainly due to depreciation against the dollar and the zloty. 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 both the CPI and the PPI moderated as well. In October 2005, the CPI-deflated real effective exchange rate firmed by 4.4% year on year. The annual appreciation of the PPI-deflated real effective exchange rate was much weaker than that of the nominal rate (just 0.5% in October), owing to substantially lower industrial producer price inflation in the Czech Republic than in other countries.

III.3 THE BALANCE OF PAYMENTS

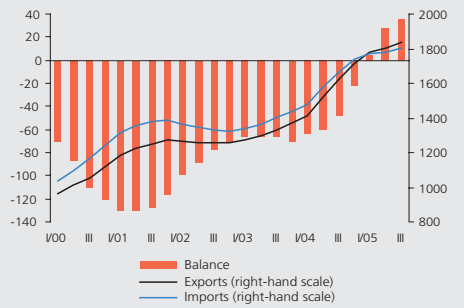
III.3.1 The current account

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

	2002 Q1-Q3	2003 Q1-Q3	2004 Q1-Q3	2005 Q1-Q3
A. Current account	-92.1	-94.5	-107.2	-44.9
Trade balance	-40.8	-36.1	-14.7	42.2
Services	20.7	10.4	11.1	12.3
Income	-83.3	-79.7	-109.1	-114.9
Transfers	11.3	10.9	5.5	15.5
B. Capital account	-0.1	-0.1	4.1	2.8
C. Financial account	316.1	89.9	104.7	122.7
Direct investment	247.5	80.3	88.2	211.9
Portfolio investment	6.7	-55.3	62.6	-53.5
Financial derivatives	-3.6	2.3	2.8	-3.8
Other investment	65.5	62.6	-48.9	-31.9
D. Errors and omissions	-12.1	15.1	4.7	9.0
Change in reserves (- = increase in reserves)	-211.7	-10.4	-6.2	-89.6

In the period between January and September 2005 the current account ran a deficit of CZK 44.9 billion, or 2.1% of GDP. This was the lowest deficit since 1999. The year-on-year improvement in the current account amounted to CZK 62.3 billion. This improvement again chiefly reflected an improvement in the trade balance (of CZK 56.9 billion year on year) and an improvement of roughly CZK 10 billion in transfers, connected primarily with damages paid to CSOB by the Slovak Republic. However, the year-on-year improvement on the current account was counteracted by continuing year-on-year growth in the income deficit, related above all to non-residents' rising FDI earnings, and, to a lesser extent, by a growing deficit on compensation of employees.

Chart III.11
The annual moving total of the trade surplus further increased in 2005 Q3
(CZK billions)

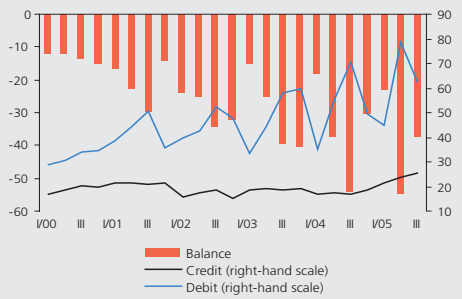


The trade surplus amounted to CZK 42.2 billion in 2005 Q1–Q3, a year-on-year improvement of CZK 56.9 billion as mentioned above. This improvement again chiefly reflected changes in the SITC 7 category (machinery and transport equipment), where the surplus increased by CZK 60.0 billion. A major year-on-year improvement was also visible in the manufactured goods category. 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. However, this improvement was offset by a deterioration of CZK 27.6 billion in the SITC 3 category (mineral fuels). Around two-thirds of this deterioration was due to a price effect related to year-on-year growth in oil and natural gas prices, while the rest was caused by an increase in the physical volume of imports. The changes in other categories were rather insignificant. From the geographical perspective, the trade balance improvement was again due primarily to an increase in the trade surplus with the EU(25), which grew by CZK 43.8 billion to CZK 213.5 billion. However, the balance also improved (deficits decreased) with other major trading partners – the USA, Japan and China. This was due mostly to declining imports, but in the case of the United States it was also due to a rise in exports, which was even more important from the point of view of the improving balance. Moreover, the trade deficit with the USA was virtually eliminated. Among the Czech Republic's major partners, only the trade balance with Russia deteriorated. The negative 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. In Q3, the trade balance showed a surplus of only CZK 0.3 billion. The main reasons for this substantial fall in trade surplus in Q3 were one-off imports of fighter aircraft, rising oil and natural gas prices and a relatively large deterioration in the terms of trade in Q3 (-2.9%).

In 2005 Q1–Q3, the surplus on services saw a modest year-on-year increase (+CZK 1.1 billion) to CZK 12.3 billion. An increase in surplus was apparent especially in transport (of CZK 3.0 billion), particularly air transport. Some signs of improvement also started to emerge in travel. The balance on other services continued to deteriorate, however, due to faster growth in payments, particularly for intermediation services, rental and leasing, reinsurance, financial services, licence fees, etc. In Q3, the services balance ran a surplus of CZK 3.9 billion, a year-on-year improvement of CZK 0.9 billion, chiefly thanks to a rise in the surplus on travel.

The income deficit for 2005 Q1–Q3 increased further year on year, to CZK 114.9 billion, a rise of almost CZK 6 billion. This was attributable chiefly to the still rising earnings of non-residents, which were visible under both foreign direct investment and portfolio investment. Payments of dividends increased, but, according to preliminary estimates, reinvested earnings grew as well. The deficit under compensation of employees recorded a further increase, mainly as a result of the rising number of foreigners working in the Czech Republic. The rise in deficit was offset primarily by an increase in income on CNB international reserves and commercial banks' interest income on deposits abroad. In Q3, however, there was a marked year-on-year decrease in deficit of about CZK 17 billion, due in part to slight growth in revenues, but primarily to a sizeable year-on-year fall in expenditure. This fall, however, occurred largely because in 2005 dividends were paid in Q2 to a greater extent than usual.

CHART III.12
The income deficit decreased significantly year on year in 2005 Q3
(CZK billions)



Current transfers recorded a surplus of CZK 15.5 billion for 2005 Q1–Q3, up by CZK 10.0 billion on a year earlier. However, this improvement was due exclusively to damages paid by the Slovak Republic to CSOB in Q1 for losses dating from the division of Czechoslovakia under an international arbitration decision (CZK 12.6 billion). CSOB kept these funds in Slovakia. Adjusted for this transaction, the current transfers balance continued to record the moderate year-on-year deterioration observed since 2002. In Q3, the transfers balance showed a surplus of only CZK 0.4 billion, which represents a year-on-year deterioration of about CZK 1 billion. This was primarily attributable to the Czech Republic's deficit of CZK 2.1 billion in relation to the EU budget.

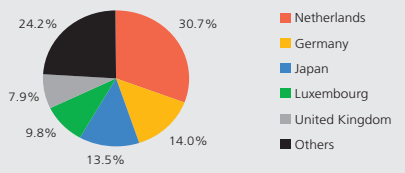
III.3.2 The capital account

The capital account ended in a surplus of CZK 2.8 billion for 2005 Q1–Q3 (compared to CZK 4.1 billion in the same period a year earlier). This year-on-year deterioration was due to lower drawings from the EU Structural Funds, which are the most important revenues under the capital account.

III.3.3 The financial account

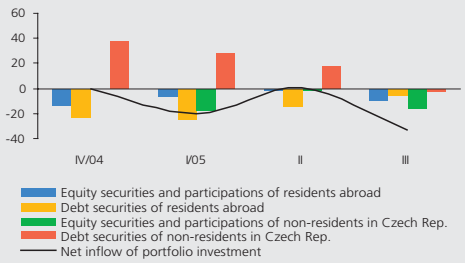
The financial account ended 2005 Q1–Q3 in a surplus of CZK 122.7 billion (compared to a surplus of CZK 104.7 billion recorded in the same period of 2004). The annual growth in the financial account surplus was due to a rise in the direct investment surplus, which, in turn, was affected by one-off sales of property to non-residents and, to a lesser extent, by an annual increase in reinvested earnings of non-residents in the Czech Republic and also a rise in the volume of funds obtained by the government from abroad (drawings on loans and de-blocking of assets) under other investment. The financial account surplus was reduced chiefly by a change in portfolio investment flows (inflow being replaced by outflow), which was associated largely with the effects of monetary policy (particularly the lowering of domestic interest rates) and an increase in commercial banks' short-term foreign assets and a decline in their short-term foreign liabilities.

Chart III.13
Firms registered in the Netherlands were the largest foreign investors in 2005 Q1-Q3



Direct investment recorded a surplus of CZK 211.9 billion for 2005 Q1–Q3, representing a sizeable annual rise in net inflow (of CZK 123.7 billion). The inflow of foreign direct investment (including reinvested earnings) was CZK 224.3 billion, which represented a year-on-year rise of CZK 133 billion. Sales of property to non-residents (Telecom, Unipetrol, TV Nova) accounted for most of the FDI; their total price, including additional purchases of Telecom shares from minority shareholders, slightly exceeded the aforementioned annual improvement in the direct investment balance. Reinvested earnings of non-residents again slightly increased and are estimated at CZK 60 billion. With the exception of the major sales of property mentioned above, the foreign capital inflow continued falling slightly year on year, amounting to less than CZK 23 billion (including loans). It was channelled primarily into real estate (about 80%), industry (about 10%) and wholesale and retail (about 10%). The biggest investors were the Netherlands, Germany, Japan, Luxembourg and the United Kingdom. Czech direct investment abroad stood at CZK 12.4 billion. It was, however, strongly affected by a one-off financial transaction of almost CZK 10 billion between subsidiaries within the Mittal Group.

Chart III.14
Portfolio investment flowed from the Czech Republic abroad in 2005 Q3
(CZK billions)

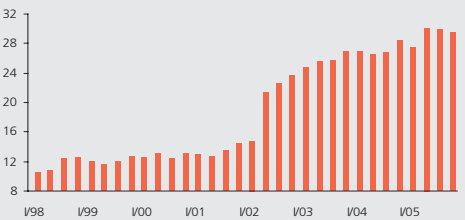


The net outflow of portfolio investment was CZK 62.7 billion for 2005 Q1–Q3, contrasting with a net inflow of CZK 53.5 billion recorded in the same period of 2004. In Q3, the net capital outflow rose by CZK 33 billion. The year-on-year change in capital flows of more than CZK 115 billion was most influenced by residents' growing interest in foreign debt securities and non-residents' declining interest in domestic koruna-denominated debt securities and shares. The change in debt capital flows was probably due 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, however, greatly affected by the purchase of foreign portfolio investors' Telecom shares by the Spanish company Telefonica (a shift to direct investment).

Financial derivatives transactions generated a CZK 3.8 billion decrease in the financial account surplus.

Other investment recorded a net capital outflow of CZK 31.9 billion for 2005 Q1–Q3, but in Q3 alone a capital inflow was recorded. Short-term operations by the banking sector are the major item affecting other investment. Since the start of 2005 there has been an outflow of capital amounting to about CZK 80 billion via operations by the banking sector, 90% of which were short-term operations (growth in short-term assets or a decline in short-term liabilities). 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 the government Eurobond issue on the European market. The net capital outflow under other investment was partly offset by capital inflows amounting to CZK 28.5 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 17.5 billion (consisting mostly of short-term trade credits).

Chart III.15
The international reserves decreased moderately in dollar terms in 2005 Q4
(USD billions)



The international reserves decreased by CZK 8.7 billion to CZK 725.2 billion in 2005 Q4. This was due mostly to valuation changes and, to a lesser extent, to continuing sales of returns on reserve holdings on the foreign exchange market. In dollar terms, the reserves decreased by USD 0.4 billion to USD 29.5 billion. Since the start of the year they have increased by almost CZK 90 billion (chiefly because of transactions to eliminate the impacts of the sale of the state-owned stake in Telecom on the foreign exchange market).

III.4 MONETARY DEVELOPMENTS

Money growth slowed in Q3, but picked up again in October and November. The primary factor behind the faster M2 growth was a slowdown in the decline of net credit to government. The low level of nominal interest rates encouraged demand by economic agents for liquid money. The favourable financing conditions also fostered further growth in credit. Credit to foreign-controlled corporations accelerated amid lower borrowing from abroad. Housing loans and consumer credit continued to grow, leading to a further rise in their ratio to GDP. After increasing in October, the overall interest rate on new loans fell, but remained higher than at the end of Q3.

III.4.1 Money

Annual M2 growth continued to slow in Q3. In October and November, however, M2 rebounded to 6.8% (see Chart III.16). Its annual rate of growth adjusted for exchange rate movements and other effects also increased, to 7.1%. October and November saw a significant increase in the growth rate of deposits by non-financial corporations (of 6.6 percentage points to 9.6%), while household deposit growth rose by 0.6 percentage point to 4.7% (see Chart III.17).

The pick-up in M2 growth was chiefly due to M1. Annual M1 growth fell in Q3, rose significantly in October and increased further to 10.5% in November (see Table III.2). Overnight deposits followed a similar pattern, growing by 10.6% in November. The rate of growth of currency in circulation increased throughout the period under review to stand at 10.2% in November. This was in line with a moderate pick-up in households' consumption expenditure in Q3. Annual growth in quasi money declined in Q3, fell below zero in October, and then rose again in November to 2.6%, roughly the same level as recorded in Q3.

The primary factor underlying the slower M2 growth in Q3 was a further increase in the negative annual growth rate of net credit to government. There was a correction in October and November, with the negative annual growth rate easing to -62.1% (of which -45.6% in the case of central government). This reflected a slowdown in the growth of central bank deposits with banks, which may have been connected with higher transfers to budgetary and subsidised organisations in November compared to a year earlier and the subsequent use of those funds in the economy. Growth in net external assets rose in Q3 and reached 19.6% in November. The annual rate of growth of domestic loans to corporations and households (adjusted for exchange rate movements and other effects) again contributed to M2 growth and was 19.9% in November.

The share of M1 in M2 continued to rise in the period under review, reaching a historical high of 54.9% in November. This confirms the continuing demand of economic agents for liquid money. Within M1, the opportunity cost of holding liquid money, expressed by the spread between the interest rate on deposits with an agreed maturity of up to one year (accounting for roughly 56% of new non-overnight deposits) and the rate on overnight deposits, rose slightly owing to the October interest rate growth. However, it remains relatively low at around 1 percentage point for both non-financial corporations and households.

III.4.2 Credit

Credit to corporations and households continued to grow in Q3, reaching 18.7% in November (see Table III.3). This trend was accompanied by a decrease in the overall interest rate on new loans in Q3, an increase in October and another decrease in

Chart III.16
Monetary aggregate growth picked up in October and November after slowing in Q3
(annual percentage changes)

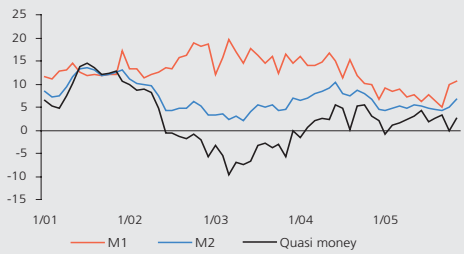


Chart III.17
Deposits by non-financial corporations accounted for most of the pick-up in M2 growth
(annual percentage changes)

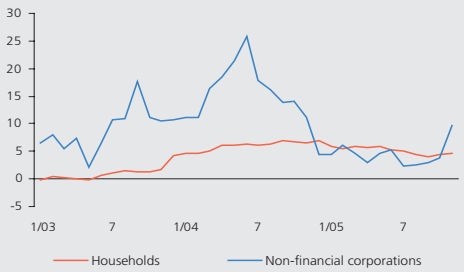


Table III.2
M1 growth increased in October and November
(quarterly averages and end-of-month stocks; annual percentage changes)

	I/05	II/05	III/05	10/05	11/05	Outstanding amount as % of M2 11/05
M1	8.8	7.0	6.4	10.0	10.5	54.9
Currency in circulation	7.7	8.2	8.3	9.2	10.2	13.4
Overnight deposits	9.1	6.5	5.7	10.2	10.6	41.5
M2-M1 (quasi money)	0.6	3.2	2.6	-0.2	2.6	45.1
Deposits with agreed maturity	-1.0	2.1	0.7	-3.2	0.2	34.1
Dep. bills of exch. and other bonds	-6.2	-8.4	-1.1	-7.6	0.3	5.7
Deposits redeemable at notice	8.8	10.3	10.5	10.2	11.5	10.5
Repurchase agreements	-37.4	-46.7	-9.9	15.5	-0.5	0.5
M2	4.8	5.1	4.5	5.0	6.8	100.0

Table III.3
The rapid growth in lending continued
(quarterly averages and end-of-month stocks; annual percentage changes)

	I/05	II/05	III/05	10/05	11/05	Outstanding amount as % of total loans 11/05
Non-financial corporations	9.4	11.4	12.7	11.3	11.5	51.3
Loans up to 1 year	2.9	7.3	12.9	9.0	9.9	20.7
Loans over 1 year and up to 5 years	14.8	19.1	14.0	14.1	12.7	13.0
Loans over 5 years	13.9	11.0	11.9	12.0	12.4	17.6
Households	31.5	32.6	33.2	33.1	33.2	36.9
Consumer credit	24.9	31.1	32.1	31.1	32.3	7.8
Housing loans	32.7	34.7	35.9	35.4	35.0	25.1
Other loans	37.2	23.5	20.6	23.9	24.5	4.0
Non-monetary financial institutions	1.6	1.7	6.6	11.5	10.5	11.8
Total loans	15.1	16.7	19.0	18.6	18.7	100.0

Chart III.18
Lower borrowing from abroad than from domestic sources continued in Q3
(annual flows; CZK billions)

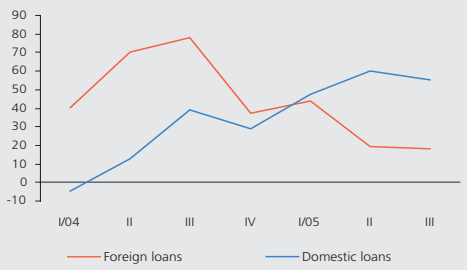


Chart III.19
The ratio of MFI loans to households to GDP increased, but is lower than in the euro area
(percentages)

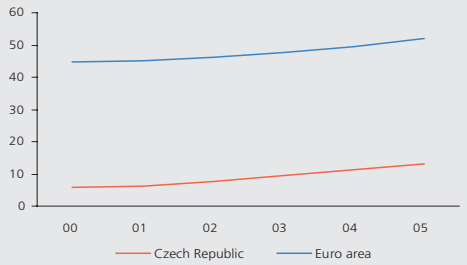


Chart III.20
The interest rate on new consumer credit fell
(percentages)

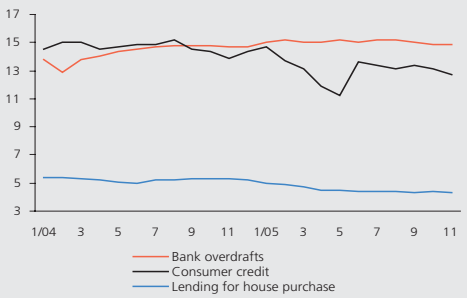
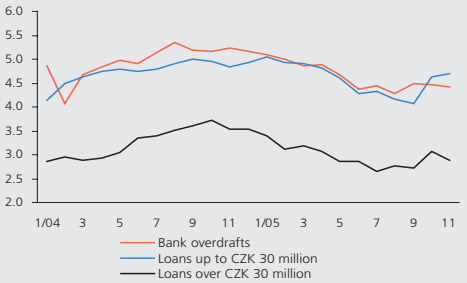


Chart III.21
The interest rate on new loans to non-financial corporations of up to CZK 30 million increased
(percentages)



November, to 5.4%. The ratio of loans to households to total loans has increased over the past six years and stood at 38.1% in November. This is linked with gradual convergence to the level in the euro area, where the ratio is roughly 51%.

After increasing in Q3, year-on-year growth in loans to non-financial corporations recorded a moderate decrease in October and November, to 11.5%. Growth in credit to foreign-controlled corporations rose to 17.0%, while that to domestic corporations fell to 9.5% over the whole period under review. The evolution of credit to foreign-controlled non-financial corporations confirms a gradual downward trend in borrowing from abroad as a result of the interest rate differential, although the decrease in the net annual flow of loans from abroad halted in Q3 (see Chart III.18).

Non-financial corporations demanded both short-term and long-term loans in Q3. Short-term loans recorded higher growth particularly in foreign-controlled corporations, owing to the favourable interest rates and the need of corporations to finance their operating needs from external sources. Growth in long-term loans was higher in both domestic and foreign-controlled corporations. Conversely, growth in medium-term loans to both categories of corporations was again lower in the period under review. In terms of sector structure, loans to services, i.e. trade, maintenance and repair, and loans for the manufacture and repair of machinery and manufacture of transport equipment were the biggest contributors to the total loan growth in Q3 and November. By contrast, loans for rental of machinery and equipment showed lower growth, again owing to lower interest in leasing than borrowing for car purchases.

Growth in loans to households increased slightly in Q3 and stayed at 33.2% in November. Housing loans accounted for two-thirds of these loans. Their rate of increase accelerated in Q3, but then slowed moderately in October and November to 35%, returning to roughly the end-2004 level. The relatively fast growth in consumer credit, visible roughly since mid-2004, continued. This was in line with a moderate pick-up in households' consumption expenditure growth in Q3. Moreover, the interest rate on new consumer credit declined in November (see Chart III.20). The ratio of MFI loans to households to GDP rose by a further 0.8 percentage point in Q3, to 13.2%. The ratio of loans from other financial intermediaries was less significant. The ratio of MFI loans to households to GDP is still lower than in the euro area, where it is about 52% (see Chart III.19). Total financial liabilities form more than one-third of households' financial assets in the Czech Republic. Growth in financial assets slowed in Q3, and this was accompanied by a decline in the gross saving rate. The debt burden of households was again favourably affected by the low interest rates. According to the CZSO's household budget survey, the average monthly repayment/instalment per person is 3.6% of gross money income.

The overall interest rate on new loans declined in Q3, rose in October, then fell again in November, to 5.4%. The October interest rate increase was reflected in rates on housing loans with longer fixations and small loans to non-financial corporations of up to CZK 30 million (see Chart III.21). Conversely, rates on consumer and housing loans with shorter fixations dropped compared to September.[9] Their decline at a time of policy rate growth may be a result, *inter alia*, of gradual convergence to the euro area, where rates on consumption in particular are much lower. Bank overdraft rates also decreased slightly, but their link to the policy rate is generally weaker. Some interest rates, especially those on large loans to non-financial corporations, increased in October, but then fell in November almost to their September level. The overall interest rate on new loans declined in November, but remained higher than before its October increase.

[9] Following a rise in October, the annual percentage rate of charge on new koruna loans, which includes fees, also fell – to 14.7% for consumer credit and to 4.5% for loans for house purchase.

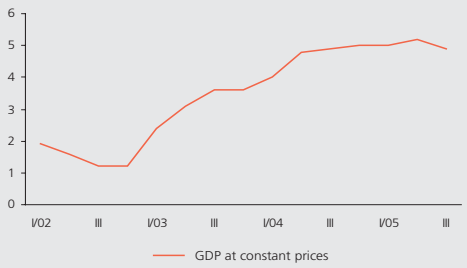
III.5 DEMAND AND OUTPUT

The phase of buoyant growth of the Czech economy, which started in 2003, continued into 2005 Q3. Compared to the previous quarter, annual real GDP growth slowed by 0.3 percentage point to 4.9%.[10] GDP formation increased by 5% over the first three quarters of 2005. According to the CNB's estimates, however, the economy remained below potential (non-inflation accelerating) output. The output gap closed somewhat, but stayed negative.

On the demand side, all expenditure components excluding inventories contributed to the rapid GDP growth, particularly a year-on-year improvement in net exports and a pick-up in final consumption expenditure growth. The favourable net exports were recorded amid relatively fast growth in both exports and imports. The improvement was due primarily to greater annual growth in exports than imports in absolute terms. Strong growth in real exports was fostered by favourable developments on the supply side and a modest recovery in external demand. This attested to the rising export performance of the Czech economy.

Within domestic demand, faster increases in consumer and investment demand were the major driving force behind the GDP growth in Q3. The contribution of government demand suggested a recovery in government expenditure growth after a prolonged period of annual decline, even after adjustment for an extraordinary one-off expenditure item.[11] On the supply side of the economy, the economic growth of 4.9% was driven primarily by the industry and services sectors.

CHART III.22
The buoyant growth of the Czech economy continued into 2005 Q3
(annual percentage changes)



III.5.1 Domestic demand

Final domestic demand growth picked up pace in 2005 Q3. All its components contributed to the growth. Although households' consumption expenditure growth increased only slightly in Q3 (to 2.9%), it was the biggest contributor to the final domestic demand growth. As in Q2, the evolution of final government consumption expenditure was affected to a great extent by the one-off inclusion of expenditure on combat technology. Adjusted for this expenditure item, government demand rose by 2.1%, partly contributing to the increase in final domestic demand. By contrast, gross capital formation fell year on year (by 3.9%), owing to lower additions to inventories than a year earlier. However, investment in fixed capital recorded an annual increase of 3.2% and partly offset the negative impact of inventories on total gross capital formation.

TABLE III.4
Final consumption expenditure increased in 2005 Q3
(annual percentage changes)

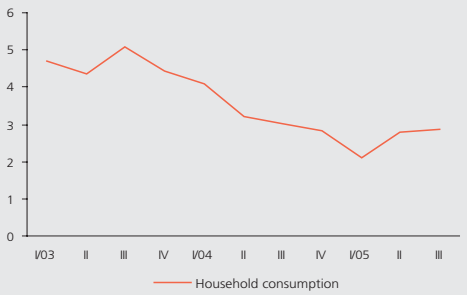
	2004 Q1	2004 Q2	2004 Q3	2004 Q4	2005 Q1	2005 Q2	2005 Q3
Gross domestic product	4.0	4.8	4.9	5.0	5.0	5.2	4.9
Final consumption expenditure	1.9	2.2	1.1	0.7	1.2	2.2	3.8
of which:							
Household consumption	4.1	3.2	3.0	2.8	2.1	2.8	2.9
Government consumption	-2.8	-0.2	-3.5	-4	-0.9	0.7	6.1
Non-profit institutions serving households	7.6	10.5	13.6	13.5	4.5	3.8	3.6
Gross capital formation [a]	10.6	9.7	8.2	2.8	-2.6	-3.8	-3.9
Gross fixed capital formation	7.4	5.2	5.0	3.9	2.5	2.9	3.2
Net exports of goods and services (CZK billions)	-44.3	-60.7	-55.4	-64.7	-21.5	-31.0	-38.1
Imports of goods and services	10.9	27.7	18.9	15.9	10.6	0.2	6.1
Exports of goods and services	10.7	29.1	22.7	22.6	17.9	6.8	10.9

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

Consumer demand

Consumer demand rose by 2.9% in 2005 Q3. As expected, its year-on-year growth increased moderately compared to 2005 H1. The structural evolution of households' consumption expenditure indicated that the recovery in consumer demand was taking place primarily in the segment of durable consumer goods. Their annual growth has been increasing gradually since early 2005, and reached 11.2% in Q3.[12] Households' increased propensity to consume durable consumer goods seemed to be fostered by several concurrent factors, particularly the continuing low growth in prices of many consumer goods,[13] the ongoing expansion of housing construction and the easy interest rate component of the monetary conditions. By contrast, growth in households' expenditure on non-durable

CHART III.23
The upswing in consumer demand continued into 2005 Q3
(annual percentage changes)



10 The GDP assessment is based on the CZSO's revised estimate of GDP growth in 2004 and 2005.
11 For details see section III.5.1 *Domestic demand*.
12 Expenditure on household equipment recorded a particularly strong increase.
13 The household consumption deflator rose by only 1.5% in 2005 Q3.

consumer services and goods remained moderate and did not exceed 2%. These basic characteristics of the consumption behaviour of households were in line with the CZSO's survey of consumer confidence of households, which stayed high in Q3.

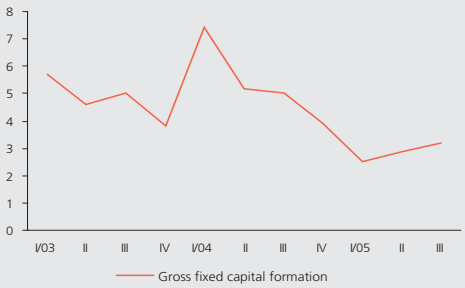
Chart III.24
Households saved less in 2005 Q3 than in the same period a year earlier
(percentages)

Gross disposable income remained the main source of financing of the increased household consumption expenditure in 2005 Q3. Its annual nominal growth was 3.8%, roughly the same as the average figure for the previous two quarters. At 2.3%, real growth in gross disposable income was slower, owing to annual inflation. As in the previous quarter, however, households' consumption expenditure rose faster than their disposable income (by 4.4% in nominal terms and by 2.9% in real terms). Under these circumstances, households realised their consumption expenditure in Q3 through lower saving and higher borrowing. This was evidenced by an annual decline in gross saving of 4.5% and a decrease in the gross saving rate[14] of 0.5 percentage point to 5.7%. Borrowing from MFIs to finance household consumption also increased, with annual growth in consumer credit remaining in double figures (for details see section III.4 *Monetary developments*).

Wages and salaries, which rose at the same pace as in Q2 (by 5.7% year on year), remained the largest component of gross disposable income in 2005 Q3. Other components of household income showed mixed developments. On the one hand, there was increased growth in income from gross operating surplus and mixed income, social benefits and other current transfers. On the other hand, the rate of growth of households' gross disposable income was reduced by a slowdown in property income growth and an increase in taxes and social contributions.

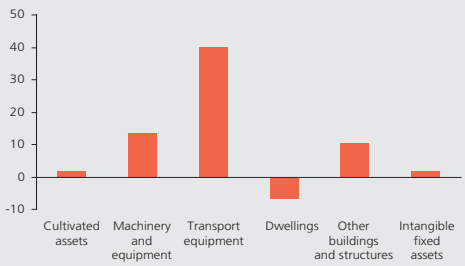
Investment demand

Chart III.25
Investment demand growth showed a further modest rise in 2005 Q3
(annual percentage changes)



According to the CZSO's latest estimates, year-on-year gross fixed capital formation growth showed a further modest rise in 2005 Q3, to 3.2%. As in the previous two quarters, the funds went mainly into "technological investment"[15], which accounts for about 60% of total investment. Investment in transport equipment recorded a particularly strong increase; this category has seen growth of more than 15% since the start of 2005. The contribution of investment in machinery and equipment to the total annual investment growth was lower, but this type of investment was still the dominant component of technological investment (almost 70%). Its growth was connected mainly with supplies of machinery and equipment for large-scale investment projects. Growth in gross fixed capital formation in Q3 was also supported by a recovery in construction output growth in the category of non-residential buildings and structures. By contrast, investment in dwellings declined year on year for the third consecutive quarter.

Chart III.26
Investment in machinery and transport equipment was the biggest contributor to investment growth
(annual changes in CZK billions; 2005 Q3)



The government sector seems to be the only monitored economic sector to have contributed to the modest pick-up in investment demand in 2005 Q3.[16] This was indicated by annual growth in state and local budget expenditure of 6.4% at current prices in Q3. Conversely, the continuing decline in investment in dwellings (5.2% in Q3) suggested that household investment demand again did not contribute to investment growth in the economy in Q3. This was probably due mainly to the increasing excess supply on the housing market. However, relatively robust growth in housing starts (26.3%) indicated that construction companies expect household investment to recover in the period ahead. In Q3, however, investment by households (small businesses) in transport equipment probably increased and contributed – along with the non-financial corporations sector – to the generally sharp growth in transport equipment investment.

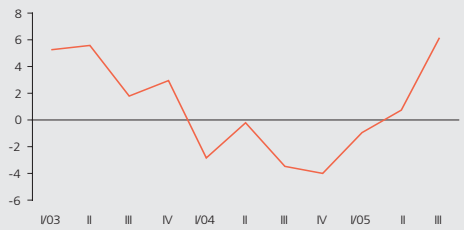
14 Gross saving rate = saving/disposable income.
15 i.e. investment in machinery and equipment and transport equipment.
16 The CZSO only publishes data on the structure of investment by kind, so the sector analysis of investment is based on partial indicators.

According to investment activity indicators for large corporations, the non-financial corporations sector probably did not contribute to the annual pick-up in real investment demand growth in Q3.[17] However, a closer look at the structure of the investment activities of large non-financial corporations reveals that the moderate decrease in investment was not across the board in nature. In fact, investment in many industries recorded annual growth.

Government demand

General government expenditure on final consumption increased in 2005 Q3 by 6.1% year on year in real terms. As in the previous quarter, this result was affected to a large extent by an extraordinary one-off expenditure item.[18] Adjusted for this item, the real increase in government expenditure would have been around 2.1%. Compared to the declines or minimal increases in government expenditure during the previous period of more than a year, this result meant a moderate upturn. At current prices, final government consumption rose by about 11.7%.

CHART III.27
Government final consumption expenditure recorded an upswing in 2005 Q3
(annual percentage changes)



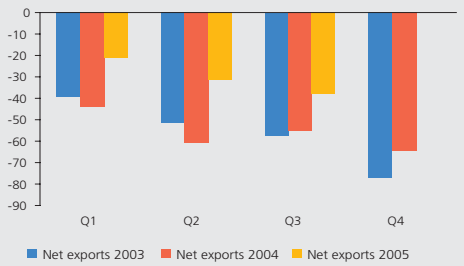
The assessment of government demand is based on an analysis of the state budget, which represents a substantial part of the government sector's performance. In 2005 Q3, the state budget ended in a surplus of almost CZK 22 billion, an improvement of about CZK 13 billion compared to the same period last year. As in the previous quarters of 2005, the favourable state budget balance was due to faster growth in revenues than expenditure. State budget revenues grew by 10% year on year, whereas the increase in expenditure was roughly one-third of that figure (3.4%).

The revenue side of the state budget was favourably affected by increases in tax, non-tax and capital revenues. The growth in revenues in Q3 was due mainly to a strong annual increase in legal entity income tax collection (16.4%), reflecting the relatively buoyant economic growth in 2004. The comparatively high increase in non-tax and capital revenues (22.1%) was due mainly to a transfer of funds from the 2004 reserves. State budget expenditure rose much slower than revenues as a result of a significant annual decline in other current expenditure (30.8%) and lower debt service (35.2%). By contrast, nominal wages of public employees, which have a direct impact on demand, grew fairly quickly (by 8.6%). Transfers of funds to regional budgets and to budgetary and subsidised organisations also recorded significant growth, but these expenditure items do not directly affect government demand. Overall, the contribution of the government sector to demand growth in Q3 was not significant despite the slight increase in final consumption expenditure.

III.5.2 Net external demand

The annual decline in negative net exports of goods and services[19] continued for the fifth consecutive quarter in 2005 Q3. In year-on-year comparison, negative net exports fell by CZK 17.4 billion to CZK -38.1 billion, so their contribution to GDP growth remained positive. This result was achieved amid generally higher turnover and a favourable trade balance. The trade balance improved further (by CZK 18.5 billion) thanks to continuing faster export growth than import growth. Unlike the trade balance, the services balance was again little changed in Q3, the deficit falling only slightly (by CZK 2.1 billion).

CHART III.28
The year-on-year decline in the net export deficit continued into 2005 Q3
(CZK billions; constant prices)



[17] In nominal terms, the indicator "Acquisition of tangible fixed assets, total" for corporations with 100 employees or more was flat year on year in Q3.

[18] Government expenditure included the supply of fighter aircraft worth CZK 9.9 billion. This item was neutral from the point of view of GDP formation, as it was simultaneously included under imports.

[19] At constant 1995 prices.

Total exports grew significantly in Q3 (by 10.9% year on year), following a sizeable decline in their growth rate in Q2. Given the high import intensity of Czech exports, import growth picked up pace as well (to 6.1% year on year). However, the lead of export growth over import growth declined moderately (to 4.8 percentage points), as the pick-up in import growth was stronger than that in export growth by comparison with Q2. From the viewpoint of total net exports, however, the key fact was that the annual increase in exports in absolute terms was higher than that in imports.

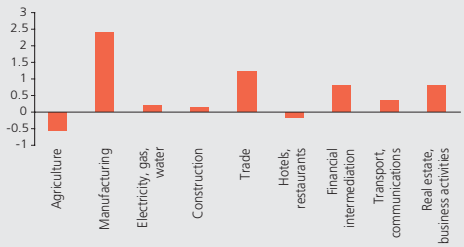
Chart III.29
Exports continued to rise faster than imports in 2005 Q3
(annual percentage changes)

In 2005 Q3, exports and imports continued to be affected mainly by developments in external and domestic demand. The decline in the net export deficit was primarily due to a pick-up in export growth, which was favourably affected by a modest upswing in external demand (for details see section III.1 *The external environment*). Exports were aided by further transfers of production from advanced market economies to the Czech Republic and by the launch of production in export-oriented facilities in the car industry. On the other hand, export growth was partly reduced by base effects related to the Czech Republic's accession to the EU. Imports for household and government consumption were the biggest contributor to the overall import growth.[20] However, investment imports remained below the previous year's level. This was due not only to the much slower growth in investment demand, but also to greater satisfaction of investment demand from domestic sources.

III.5.3 Output

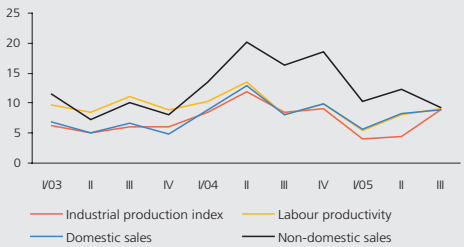
On the supply side of the economy, the GDP growth of 4.9% in 2005 Q3 was chiefly due to services and industry. Almost one-half of the increase in gross value added was created in manufacturing. The contributions of trade, financial intermediation and insurance, and real estate and business activities were also significant.

Chart III. 30
Industry and services were the biggest contributors to the 4.9% GDP growth
(contributions in percentage points; selected branches)



Gross value added in manufacturing rose rapidly, recording 8.7% year-on-year growth in Q3. It accounted for more than 80% of total gross value added in industry. Within industry, value added also increased in the electricity, gas and water supply sector (by 9.7%), but recorded an annual decline in mining and quarrying. The generally high value added growth in industry was achieved amid a rise in industrial production of 8.9%, accompanied by a sharp increase in productivity. As regards individual industries, continuing buoyant growth was recorded in machinery production, particularly the manufacture of transport equipment (23.9%), which created conditions for growth in related branches. Manufacture of coke and refined petroleum products and rubber and plastic products also expanded at a rapid pace. Conversely, there was a continuing decline in production in the textile industry – due to cheaper Asian competition – and in the manufacture of leather and leather products. As in the previous quarters, production in individual industries suggested ongoing structural changes in the economy relating to changes in demand for individual products, the ability of companies to maintain their market positions in a strongly competitive environment, and the inflow of foreign direct investment.

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



The continuing growth in industrial production was still underpinned by growth in real exports, which increased faster than domestic sales. Amid overall growth in industrial sales of 8.9%, sales from direct exports grew by 9.3% in Q3.[21] The importance of exports for industry is also visible from their almost 50% share in total sales in industry. As in the previous quarters, direct exports were largely

[20] In the case of the government, however, the reason was a one-off import of combat technology.
[21] These indices do not include exports by corporations that export through trade organisations.

realised by foreign-controlled corporations and accounted for nearly 70% of the sales of these corporations.

Gross value added in services showed very mixed developments. The biggest contribution to GDP formation was recorded in trade, where value added growth increased significantly, to 8.8%. However, value added grew fastest in financial intermediation and insurance (by 15.9%), even though its contribution to GDP growth was lower than in trade. The contribution of real estate services and services for businesses was also significant, with value added rising by 7.3% year on year. Gross value added also rose year on year in construction (by 3%). However, it fell sharply in agriculture (by 6.3%). The decline in value added in this sector after earlier strong growth greatly contributed to the slowdown in GDP growth in Q3.

III.5.4 Financial performance of non-financial corporations [22]

The financial results of large non-financial corporations for 2005 Q3 showed a continuing deterioration of the key financial indicators compared to 2004. Generation of profit from core activities fell by 4.7% year on year, owing to faster growth in costs than output including business margins. Profit from non-core activities[23] also dropped in year-on-year terms. Total pre-tax profit thus declined by 9.2% year on year in Q3.

The continuing decline in profit from core activities was due to several factors acting on both the cost and output sides. In particular, prices of imported energy-producing materials continued growing relatively rapidly in 2005 Q3, albeit with less intensity than in the previous quarter. Domestic electricity prices also rose fairly quickly. Although prices of other imported inputs declined in year-on-year terms, the material cost-output ratio increased in Q3 (by 1.2 percentage point year on year). On the other hand, strong competition on the domestic market, bolstered by the mostly falling import prices of non-energy commodities, prevented producers in many industries from reflecting their higher energy costs in prices. This was also indicated by a decrease of 1.1 percentage point in the profit margin. Corporate financial results were also adversely affected by a year-on-year decline in the terms of trade, which gave some exporters less leeway to offset the higher material cost-output ratio through export prices. Under these circumstances, 2005 Q3 saw a year-on-year fall in return on equity (of 0.5 percentage point) and the profit-expenses ratio (of 1 percentage point).

These developments had significant structural aspects, as corporations' financial results differed significantly across individual industries and as regards ownership structure. Profits deteriorated in foreign-controlled corporations and public corporations. Only private domestic corporations generated higher profits. The proportion of loss-making corporations increased by comparison with Q2. Profit generation in Q3 decreased more significantly year on year for example in the manufacture of rubber and plastic products, basic metals and fabricated metal products, electrical and optical equipment, and pulp, paper and paper products. The main factor underlying the falling profits in these branches was deteriorating income[24], which was not accompanied by a corresponding cost development. The profit-expenses ratios in all these industries decreased year on year in Q3, testifying also to the influence of the faster growth in prices of energy inputs.

Chart III.32
Exports were due predominantly to foreign-controlled firms
(2005 Q3; shares in total industrial sales - domestic and external - at constant prices)

Table III.5
Profit generation decreased overall in 2005 Q3
(annual percentage changes)

		2005 Q3	
		Organisations, total	Industry
Income		7.6	5.1
Sales		9.0	-
Output		7.9	7.8
Expenses		8.7	6.6
of which:	cost of sales	9.8	9.8
	personnel costs [a]	7.8	7.1
	depreciation	3.7	3.9
Book value added		3.5	1.9
Pre-tax profit		-9.2	-14.6
Net operating surplus		-4.7	-7.4

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

Table III.6
The profit-equity and profit-expenses ratios both worsened
(percentages; percentage points; CZK thousands)

	2005 Q3 in per cent		Change in perc. points against 2004 Q3	
	Organisations, total	Industry	Organisations, total	Industry
Profit-expenses ratio	5.3	6.0	-1.0	-1.4
Profit-equity ratio	3.1	3.2	-0.5	-0.7
Profit-sales ratio	5.5	6.1	-1.1	-
Asset turnover	29.3	27.5	1.2	-
Financial leverage	1.9	1.9	0.0	0.0
Material cost-output ratio	71.9	75.7	1.2	1.4
Personnel cost-output ratio	15.1	12.0	0.0	-0.1
Ratio of wage costs to value added	53.6	49.5	2.1	2.4
	CZK thousands per month		annual percentage changes	
Book value added per employee	51.5	54.4	2.5	1.2

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

23 This profit is affected by extraordinary income (e.g. sale of assets) and extraordinary costs (acquisition of assets, penalties, etc.).

24 In the manufacture of electrical and optical equipment and fabricated metal products, for example, income recorded a year-on-year decline in Q3.

The year-on-year decline in profit generation in Q3 was not across the board in nature. On the contrary, profit generation increased in a number of industries. For example, larger increases were recorded in the manufacture of transport equipment, chemicals, chemical products and man-made fibres, as well as in transport, storage and communications, construction and real estate and rental activities. In the overwhelming majority of these industries, the increase in profit was not accompanied by a rise in price growth compared to the previous period.

III.6 THE LABOUR MARKET

The continuing gradual increase in employment in the economy in 2005 Q3 was consistent with the phase of buoyant economic growth and the inflow of foreign direct investment. Increasing employment in the secondary and tertiary sectors in turn helped reduce unemployment. However, the cyclical component of registered unemployment did not decline to the extent corresponding to the changes in employment. The increasing demand for labour did not manifest itself in higher growth in vacancies registered by labour offices, either. The discrepancy between employment and unemployment development in the economy was mainly due to the skills and professional structure of the unemployed and to the satisfaction of labour demand outside labour offices. This resulted in persisting high long-term unemployment. Growth in average wages increased, although it remained subdued in the business sector. Nominal unit wage costs rose slightly faster than in the previous quarter due to higher growth in wages in the non-business sector, although they continued to record an annual fall in industry.

CHART III.33
The recovery in employment growth continued into 2005 Q3
(annual percentage changes; percentage points)

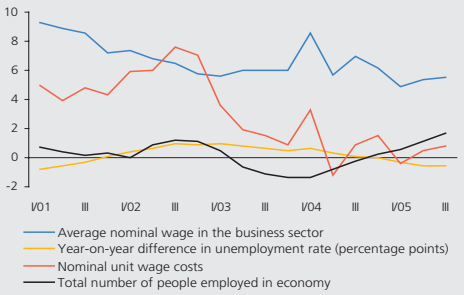


CHART III.34
Employment rose only in the employees category
(annual percentage changes)

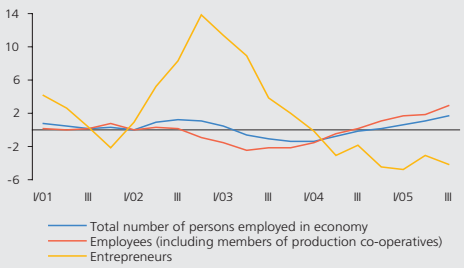
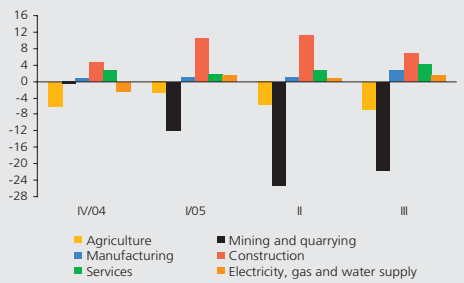


CHART III.35
Demand for labour increased in the secondary and tertiary sectors
(annual percentage changes; 2005 Q3; source: LFS)



III.6.1 Employment and unemployment

The evolution of employment in 2005 Q3 confirmed a continuing recovery of labour demand in the economy. Annual growth in the number of employed persons picked up further, rising by 0.6 percentage point compared to 2005 Q2 according to LFS figures, to 1.7%. As shown in Chart III.34, employment continued to increase only in the category of employees (by 2.9%)[25], while the number of entrepreneurs continued to decline year on year in 2005 Q3 (by 4.1%). This was largely associated with an improving supply of steady employment opportunities in an environment of buoyant economic growth and foreign direct investment inflow.

Increasing demand for labour was apparent in the secondary and tertiary sectors, which were the main sources of economic growth in 2005 Q3. The primary sector again saw an annual fall in employment, owing to a downturn in some activities.[26] The largest increases were recorded in the numbers of persons employed in construction, services and manufacturing. In construction, increased demand for labour was recorded in civil engineering and construction and assembly work. It was also indicated by an increasing number of hours worked. In manufacturing, the continuing employment growth was largely associated with foreign direct investment, as evidenced by an above-average rise in the number of employees in large foreign-controlled non-financial corporations. In services, the largest increases in employment were recorded in education, real estate, business activities and some components of public administration. However, the upturn in employment was still not across the board in nature in Q3. On the contrary, a number of branches

[25] Including members of production co-operatives.

[26] Of almost 17,000 people year on year. By contrast, employment increased by 41,900 and 54,200 people in the secondary and tertiary sectors respectively.

(transport, agriculture, etc.) showed a decline in employment due either to strong competition exerting downward pressures on costs or to demand-side developments.

As in previous quarters, the rising employment in a number of branches was not accompanied by greater creation of vacancies registered by labour offices. In fact, the annual growth in vacancies has been declining for several months, and was less than 1,000 in December. This suggested that the increased demand for labour was largely generated outside the labour office register.[27]

Unemployment did not show any further improvement despite the continuing growth in employment in the economy. The annual decline in the number of unemployed persons (of around 31,000 in December) and the registered unemployment rate (9.7%)[28] was slightly lower than in the previous quarter. Seasonally adjusted registered unemployment declined primarily because of a higher number of exclusions of job applicants as a result of penalties applied under the new Act on Employment.[29] More detailed analyses of labour market developments suggest that the discrepancy between employment and unemployment development in the economy was mainly due to the fact that the main source of the increasing employment was labour force not yet registered at labour offices, in particular new graduates and foreign workers in a number of industries.

The gradual cyclical improvement in the situation on the labour market has not yet fostered a narrowing of the regional, skills and professional gaps between the supply of, and demand for, labour. Although the share of the long-term unemployed[30] in the total number of people unemployed declined by 0.4 percentage point in 2005 Q3 compared to the previous quarter, it still exceeded 50%. The recorded figure of 53% is one of the highest since 1993.

III.6.2 Wages and productivity

The annual rate of growth of average nominal wages picked up in 2005 Q3 (to 6.2%). Nevertheless, this change did not represent a significant break in the downward trend in average nominal wage growth in the national economy observed since the start of 2004. Average nominal wages continued to grow more slowly in the first three quarters of 2005 than in the same period a year earlier. At 4.2%, growth of average real wages was lower than that of nominal wages, due to annual inflation.

The faster growth in average nominal and real wages in Q3 was mainly due to wages in the non-business sector, which are usually "jumpy", reflecting the implementation of related government measures and the capacities of the state budget. The marked pick-up of 3.2 percentage points (to 8.6%) in annual average wage growth in this sector in Q3 compared to 2005 Q2 was due to large pay increases in some professions[31] at the start of 2005, which were partly offset by the abolition of the "thirteenth" and "fourteenth" paycheques.

Chart III.36
Excluding seasonal effects, creation of vacancies was flat
(seasonally adjusted numbers in thousands)

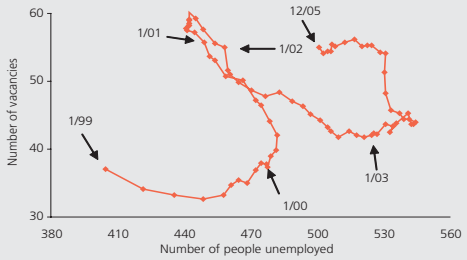


Chart III.37
Structural unemployment prevented any larger fall in unemployment, and the share of long-term unemployment remained high
(percentages; source: LFS)

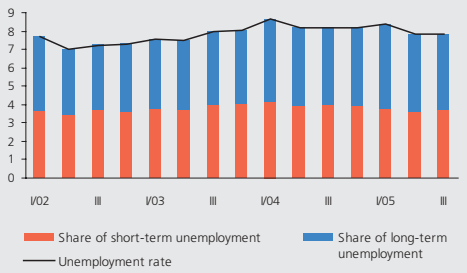


Table III.7
Average nominal wage growth picked up in 2005 Q3, but was lower than in 2004
(annual percentage changes)

	2004 Q1	2004 Q2	2004 Q3	2004 Q4	2004	2005 Q1	2005 Q2	2005 Q3
Average wage in monitored organisations								
nominal	8.8	4.2	7.3	6.3	6.6	5.8	5.4	6.2
real	6.4	1.6	4.0	3.1	3.7	4.1	3.7	4.2
Average wage in business sector								
nominal	8.6	5.7	7.0	6.2	6.9	4.9	5.4	5.5
real	6.2	3.0	3.7	3.0	4.0	3.2	3.7	3.5
Average wage in non-business sector								
nominal	9.6	-0.5	8.3	6.4	5.7	8.9	5.4	8.6
real	7.1	-3.0	4.9	3.2	2.8	7.2	3.7	6.6
Whole-economy labour productivity	4.1	5.1	4.4	4.8	4.6	4.2	4.1	4.0
Nominal unit wage costs	3.3	-1.2	0.9	1.5	1.1	-0.4	0.5	0.8

27 This seems to have been most affected by temporary and flexible contracts with foreign workers.

28 Under the new methodology, the unemployment rate stood at 8.9% in December.

29 For example, job applicants who refuse to cooperate with labour offices, accept a job offer, etc. are excluded from the register of unemployed persons.

30 Unemployed for more than one year.

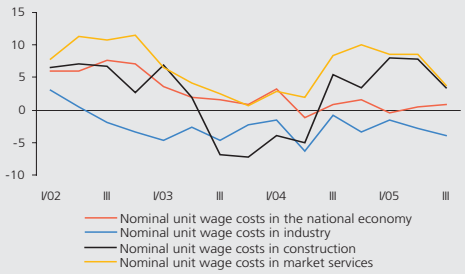
31 Salaries in the police service, the prison service, fire brigades and the customs authority increased in January 2005, and wage scales in the health sector increased by 8% in September 2005.

Chart III.38
Annual whole-economy productivity growth stabilised around 4%
(annual percentage changes)

Wages in the business sector, which accounts for around 80% of the set of all monitored organisations, were smoother compared to the non-business sector. Their growth was only slightly faster than in the previous quarter (rising to 5.5%) and, as in the first half of 2005, was lower than in 2004. The persisting subdued wage growth amid continuing buoyant economic growth was due to several factors. Wages in this sector are being affected primarily by the strongly competitive environment, which is curbing possible price growth. Other factors limiting excessive growth in average wages in the business sector included the continuing growth in prices of energy inputs and the worsening terms of trade, which adversely affected profits in the non-financial corporations sector (for details see section III.5.4 *Financial performance of non-financial corporations*). These factors led corporations to increase their productivity by raising wages more gradually or creating vacancies more slowly.

Whole-economy productivity growth was broadly flat in the first three quarters of 2005, fluctuating just above 4%. This was largely due to the corporate sector. In particular, industry saw continued fast growth in labour productivity[32], exceeding 7% on average in the first three quarters of 2005. In Q3 alone, productivity in industry rose by 9% year on year. This was largely the result of the launching of new export-oriented facilities.

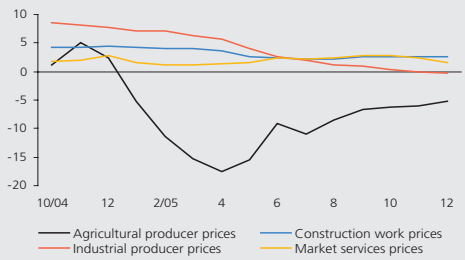
Chart III.39
Growth in nominal unit wage costs increased somewhat
(annual percentage changes; selected branches)



The interaction between wage and productivity variables indicated no major changes in the wage cost-output ratio in 2005 Q3. Annual growth in nominal unit wage costs, which is an indicator of potential inflationary pressures, picked up by 0.3 percentage point to 0.8% compared to the previous quarter. This change was due to higher growth in the average wage in the non-business sector, which in turn fostered higher growth in the total volume of wages and salaries in the national economy. In contrast, industry again saw a favourable trend in the wage cost-output ratio, amid subdued wage growth and higher labour productivity. A decline in nominal unit wage costs (of 3.9% year on year) meant a fall in labour costs, creating prerequisites for increased producer competitiveness on domestic and foreign markets. Construction saw a marked slowdown in nominal unit wage cost growth in Q3. This change, however, was due to the unwinding of base effects, which affected their development in the first two quarters of 2005.

III.7 IMPORT PRICES AND PRODUCER PRICES

Chart III.40
The slowing growth in industrial producer prices culminated in a slight year-on-year fall in December
(annual percentage changes)



The evolution of prices of energy-producing materials on world markets in the first two months of 2005 Q4 indicated continuing external cost pressures. Although their annual growth slowed significantly, import prices of mineral fuels still continued to grow quite rapidly. However, major impacts of the higher prices of imported energy-producing materials on producer prices were apparent only in sectors standing at the initial stages of the product vertical. Commodity prices in other import categories either fell year on year or rose only slightly, creating conditions for slower growth or a decline in domestic prices. Overall, annual industrial producer price inflation decreased further and in December turned negative. This was also fostered by a further deepening of the producer price decline in the food industry and slower growth in coal prices for corporations. Prices of construction work saw no substantial changes in Q4. However, growth in prices of market services in the business sphere slowed noticeably.

[32] Calculated from sales at constant prices.

III.7.1 Import prices

Given the high openness of the Czech economy, import prices are an important domestic inflation factor, acting through prices of imported production inputs and prices of final products for the domestic market. Their evolution in the first two months of 2005 Q4 indicated a continuing slight upturn in prices (of 1.4% year on year in November), which has been apparent since the end of Q2.

The upturn in import price inflation was chiefly associated with persisting very rapid growth in prices of energy-producing materials on world markets, which had exceeded 50% in August. Although the growth slowed by almost 15 percentage points in the following three months, it was still high. The slower rise in prices was moreover only recorded for oil; annual growth in natural gas prices continued to fluctuate around 50%. The impact of world prices of oil and natural gas on domestic prices was until October dampened by year-on-year appreciation of the koruna-dollar exchange rate.[33] In November, the koruna-dollar rate weakened for the first time in a long time.

Annual growth in import prices of mineral fuels fell to 30% in October in line with the development of prices of energy-producing materials on world markets. In November, however, it rebounded strongly (to 36.5%), probably owing mainly to the weakening of the koruna-dollar exchange rate. Mineral fuels were the only import category within the import price index[34] to show higher year-on-year price growth in the first two months of Q4. Prices of mineral commodities excluding fuels recorded only slight growth and the other import categories saw an annual decline in commodity prices.

The main factors underlying the very modest rise in prices of crude materials excluding fuels (0.2% in November) were a year-on-year fall in prices of iron ore, which accounts for a large proportion of imports of non-energy-producing materials, and the year-on-year depreciation of the koruna-dollar exchange rate. In the case of foods, as with non-energy-producing materials, the previous annual decline in import prices was replaced in November by modest growth (see Table III.8).

Prices of imported higher-value-added products were most affected in the first two months of Q4 by machinery and transport equipment, the highest-weight category. Their year-on-year fall eased noticeably (to -2.4%) according to the latest figures for November. This change was due to a combination of two factors – faster growth in industrial producer prices in the Czech Republic's major trading partner countries (especially Germany) and the moderation of the year-on-year appreciation of the koruna-euro rate compared to previous months.[35] A similar trend was recorded for other higher-value-added products, especially chemical products.

The mixed developments in the structure of import prices implied different impacts on the individual producer and consumer price categories. However, import prices mostly decreased, creating conditions for slower growth or a decline in domestic prices. The only exceptions were the import prices of oil and, especially, natural gas, which indicated persisting upward pressures on production costs, albeit generally to a lesser extent than in the previous quarter.

Chart III.41
Import prices rose somewhat in the first two months of 2005 Q4
(annual percentage changes; contributions in percentage points)

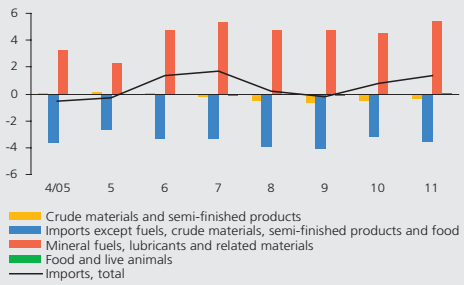


Chart III.42
The impacts of world prices of energy-producing materials on import prices were no longer dampened by the koruna-dollar exchange rate in November
(annual percentage changes)

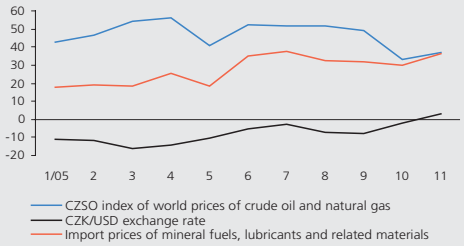


Table III.8
Prices fell in the majority of import categories
(annual percentage changes)

	6/05	7/05	8/05	9/05	10/05	11/05
Imports, total	1.4	1.7	0.2	-0.2	0.8	1.4
Food and live animals	-0.4	-1.9	-1.5	-2.4	-0.8	0.2
Beverages and tobacco	2.3	3.5	1.6	-1.6	-3.7	-4.0
Crude materials except fuels	1.2	1.2	-1.1	-2.1	-0.2	0.2
Mineral fuels and related products	34.8	37.4	32.6	31.9	30.0	36.5
Animal and vegetable oils	-11.8	-13.8	-13.8	-14.2	-12.8	-14.7
Chemicals and related products	-0.8	-1.2	-3.1	-3.6	-0.8	-2.5
Manufactured goods classified by material	0.0	-1.1	-2.5	-3.2	-2.5	-1.9
Machinery and transport equipment	-3.5	-2.5	-4.0	-4.2	-2.5	-2.4
Miscellaneous manufactured articles	-7.5	-7.6	-8.5	-8.9	-8.2	-8.2

[33] The koruna-dollar exchange rate appreciated by 12.8%, 10%, 5.9% and 2.1% year on year in Q1, Q2, Q3 and October 2005 respectively. In November, it weakened by 3%.

[34] Using the SITC classification.

[35] The koruna-euro exchange rate appreciated by 6% in 2005 Q3 and 5.5% in 2005 Q4 year on year.

III.7.2 Producer prices

Industrial producer prices

The gradual decrease in annual industrial producer price inflation, which started in 2004 H2, culminated in December in a slight annual decline in prices (of 0.3%). As in the previous quarter, the inflation slowdown was mainly associated with weakening external cost pressures.

In the final quarter of 2005, the largest decline in inflation was recorded for non-manufacturing sectors. However, this significant change took place only in mining and quarrying (from 17.8% in September to 1.2% in December). It was due to the unwinding of a step increase in coal prices in October 2004 which had been implemented in response to a rise in costs and changes in prices of other energy sources. In contrast, growth in electricity, gas and water prices, caused by increases in prices of electricity for the corporate sector, remained almost unchanged compared to the previous quarter, reaching 7.2% in December.

The considerable slowdown in producer prices in the manufacture of coke and refined petroleum products in Q4 was mainly associated with the fall in oil prices on world markets. As a result of this, producer prices in this industry, following a sizeable annual rise of 16.4% in September, rose much more slowly again in the following three months (by 4.9% in December). The declining industrial producer price inflation was also attributable to food industry prices, whose year-on-year decline deepened to 3.5%. This was primarily due to a still sharp decline in crop prices of domestic primary producers and a deepening decline in livestock product prices.

The contribution of primary metal processing to the slower industrial producer price inflation was not as significant at the end of 2005 as in the previous quarters.[36] The slowdown in growth in metal prices on world markets was more moderate, and this was reflected in an only modest deepening of the annual decline in producer prices of basic metals and fabricated metal products (of 1.4 percentage points compared to the end of Q3, to -5.5% in December). Producer prices mostly decreased in other sectors of manufacturing, too.

The structural trends in industrial producer prices remained mixed. Overall, however, the majority of sectors had falling prices, which was reflected in a continuing deepening of the annual decline in prices in manufacturing. Faster price growth was recorded only by oil-processing sectors at the beginning of the production chain and by the power generation sector. In the case of oil products, however, the rate of price growth moderated considerably. The transmission of the higher costs of energy sources and oil products into prices was not significant in the majority of other sectors. The reasons for this are analysed in more detail in sections II.1 *Past inflation developments* and III.5.4 *Financial performance of non-financial corporations*.

Agricultural producer prices

Agricultural producer prices continued to fall year on year in 2005 Q4, although to a lesser extent than in the previous quarters (by 5.2% in December). A more detailed look at the agricultural producer price index structure reveals that the continuing moderation of the annual decline was due to crop product prices.

Chart III.43
Most branches contributed to the slowdown in price growth and subsequent price decline in industry
(annual percentage changes; contributions in percentage points)

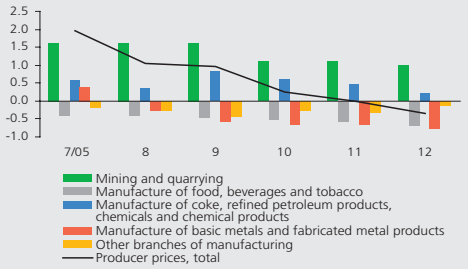


Chart III.44
The easing of external cost pressures chiefly affected prices in branches involved in primary processing of imported commodities
(annual percentage changes)

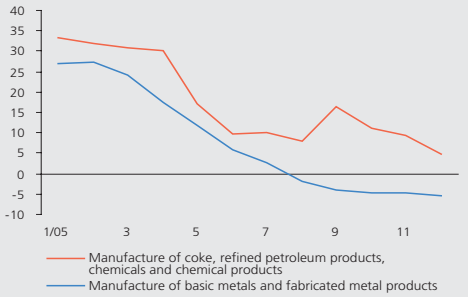
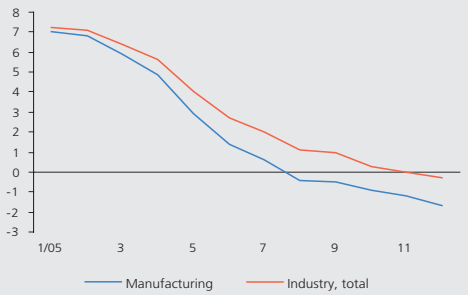


Chart III.45
Producer prices fell in most branches of manufacturing
(annual percentage changes)



[36] Producer prices in primary metal processing accounted for 80% of the fall in industrial producer price inflation in 2005 Q3, while in Q4 they accounted for a mere 15% or so.

Crop product prices were again mainly affected by prices of cereals at the end of 2005. The main causes of the persisting low prices of cereals and some other crop products[37] remain unchanged compared to the October Inflation Report. The primary reason was the record harvest in 2004, which changed the supply-demand relationship in the agricultural commodity market. Although the harvest in 2005 was poorer than in 2004 according to CZSO data, it was above the average for the past ten years. However, prices on the agricultural market signalled some changes at the end of 2005 compared to the previous period. A gradual upturn in prices of cereals in this market from their record low levels suggested that, unlike in the previous quarters, the surplus had been largely eliminated from the domestic market. Thanks to this, prices of cereals gradually approached EU intervention prices.[38]

Another important factor for crop product prices was the annual appreciation of the koruna-euro exchange rate, which reduced the level of EU intervention prices and at the same time made food imports to the domestic market cheaper. This factor fostered a decline in prices of other items, in particular potatoes, in Q3 and Q4.

Livestock product prices also recorded an annual decline at the end of 2005. They were mainly affected by base effects, as conditions for exporting livestock products to EU countries had improved sharply after the Czech Republic's accession to the EU in 2004. Due to this factor, the annual decline in livestock product prices fluctuated between 3% and 4% in Q4. This was fostered by all the main categories of livestock production except cattle.

Other producer prices

Prices in construction showed no major changes in 2005 Q4. Compared to the end of Q3, their annual growth declined only very slightly (by 0.1 percentage point to 2.6% in December), although it was mixed in structure. The main factor underlying the slight decline in construction price inflation was considerably slower growth in prices of materials and products consumed in the construction industry, which was related, in turn, to a decline in prices of imported semi-manufactures and a decline in prices of miscellaneous manufactured articles. Growth in prices of these materials declined to 0.8% in Q4.

Growth in prices of market services in the business sphere slowed overall in 2005 Q4. By comparison with the end of Q3, it was 1.2 percentage points lower in December, at 1.6%. This was chiefly due to a slackening of annual growth in market prices of business services in real estate and renting (to 0.9% in December) and postal and telecommunications services (to 3.5%). The other services categories showed no major changes in price growth compared to the end of Q3. Sewerage collection charges recorded the fastest growth, remaining just under 6% year on year.

CHART III.46
The sharp decline in crop production prices eased at the end of 2005
(annual percentage changes)

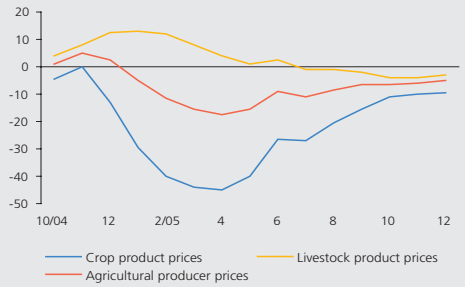
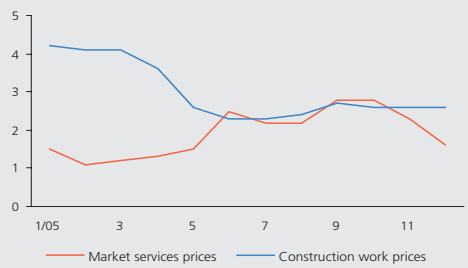


CHART III.47
Market services price inflation fell noticeably in 2005 Q4
(annual percentage changes)



[37] Prices of cereals decreased by 20.4% in September and by 10.1% in December year on year.
[38] In Q3 they had still been around 15% below the EU intervention price.

IV.1 EXTERNAL ASSUMPTIONS OF THE FORECAST

Expectations regarding the external environment are one of the key assumptions of the forecast. For this purpose, the CNB has as usual drawn on the publication Consensus Forecasts, which brings together the forecasts of a range of foreign analytical teams. The current reference scenario is based on the December data from this publication and on the euro yield curves effective on the survey date.[39] Based on this information, the assessment of the external effects on the Czech economy has shifted slightly in the inflationary direction compared to the October forecast.

Expected one-year interest rates in the euro area have shifted upwards over the entire forecast horizon since the last forecast. The reference scenario thus assumes a gradual rise in the 1Y EURIBOR nominal interest rate to 3.2% at the end of 2007. Owing to the further appreciation of the dollar in Q4, the outlook for the euro-dollar exchange rate up to the end of 2007 has again shifted towards a stronger dollar. However, the assumption of a gradual strengthening of the euro remains unchanged.

Expected 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 been increased to 1.5% for 2006, although the estimate for 2005 remains unchanged. The reference scenario assumes that economic growth in Germany will stay at 1.4% in 2007. According to a flash estimate, consumer price inflation in Germany was slightly higher in 2005 than assumed in the October baseline scenario, but the forecast for 2006 is still 1.7%. According to preliminary estimates, producer prices in Germany grew faster in 2005 than previously assumed, reaching an average annual growth rate of 4.5%. In this context, the outlook for 2006 has also been increased, to 2.5%. In 2007, consumer price inflation and producer price inflation in Germany are both assumed at 1.5%.

Owing to lower-than-expected oil price growth, Consensus Forecasts revised its oil price forecast slightly downwards during Q4. The current forecast thus works with a Ural crude oil price roughly 2% lower than the October forecast. In 2005 Q4, the average price of Ural crude oil was USD 53.3 a barrel, and the new outlook expects a gradual decline below USD 50 a barrel at the end of 2006 and subsequent stability in 2007.

Table IV.1
An only modest recovery in external demand is expected

	I/06	II/06	III/06	IV/06	I/07	II/07	III/07	IV/07
Ural crude oil prices (USD/barrel)	52.8	51.0	50.0	49.5	49.5	49.5	49.5	49.5
GDP in Germany (annual, in per cent)	1.4	1.3	1.4	1.9	1.7	1.4	1.3	1.3
Producer price inflation in Germany (annual, in per cent)	3.8	2.9	2.0	1.3	1.6	1.5	1.5	1.5
Consumer price inflation in Germany (annual, in per cent)	2.5	2.0	1.4	1.2	1.2	1.5	1.7	1.7
Nominal USD/EUR exchange rate	1.191	1.197	1.213	1.235	1.251	1.255	1.257	1.259
1Y EURIBOR	2.8	2.9	3.0	3.0	3.1	3.1	3.1	3.2

IV.2 INTERNAL ASSUMPTIONS OF THE FORECAST

In addition to assumptions regarding the external environment, assumptions about the domestic economy are an important input to the forecast. Owing to a revision of the statistical data and to preliminary data on the state budget results, the contribution of fiscal policy to economic growth in 2005 is viewed as more restrictive than expected. This to some extent changes the expectations regarding state finances going forward. According to available preliminary figures, the government sector deficit under ESA 95 methodology ended 2005 at 2.8% of GDP. The CNB's estimate of the government sector deficit for 2006 has been decreased compared to the October forecast to 2.2% of GDP, and in 2007 the deficit is expected to increase to 2.8% of GDP. The forecast thus still expects fiscal policy to have a roughly neutral effect on economic activity in 2006, whereas in 2007 fiscal policy is expected to contribute moderately to faster economic growth. At the

[39] The predictions of the January Consensus Forecasts were published after the CNB forecast had been completed and so have not been incorporated into it. Since the Consensus Forecasts publication does not include predictions for 1Y EURIBOR rates, which are inputs to the CNB forecast, the expected future evolution of these rates is derived from the euro yield curves as of the Consensus Forecasts survey date.

forecast horizon, no sizeable additional fiscal impulse is expected from the inflow of money from EU funds.

BOX
Fiscal policy in the CNB's modelling system

The monitoring, assessment and anticipation of fiscal policy is an integral part of the decision-making on the optimal monetary policy settings. Each CNB forecast therefore contains an assumption regarding future fiscal policy. This can be expressed in many ways, for example, using the government sector deficit, government consumption expenditure, the fiscal stance or the fiscal impulse.

From the point of view of monetary policy it is crucial to capture the impact of fiscal policy on inflation. Fiscal policy is inputted into the CNB's prediction model as an expert-estimated residual in the output gap equation and subsequently affects inflation through the output gap (as the output gap in the CNB's model is a proxy for the demand-pull inflation pressures in the economy). In estimating the residuals, only those government revenues and expenditures which have an impact on domestic aggregate demand have to be taken into account. We then refer to the year-on-year change in the demand-relevant balance in percentage points of GDP derived from these revenues and expenditures, as the fiscal impulse.

If the fiscal impulse is positive, fiscal policy acts towards a more open positive (or more closed negative) output gap and towards higher inflation, and we speak of easy (expansionary) fiscal policy. Conversely, if the fiscal impulse is negative, fiscal policy has the opposite effect on the output gap and inflation, and we describe it as tight (restrictive). As the fiscal impulse expresses the year-on-year change in the demand-relevant balance, it can be negative (indicating restriction) even when the government deficit is strongly negative. This fact is illustrated in Chart 1 (Box), which compares the CNB's estimate of the fiscal impulse in 1999–2005 with the public budget deficit.

The calculation of the fiscal impulse does not take into consideration the phase of the business cycle and its implications for the assessment of fiscal policy, i.e. whether a fiscal policy that is viewed as expansionary based on the estimate of the fiscal impulse is justifiable by a cyclical deterioration in the performance of the economy or vice versa. Information on how public sector finances changed year on year excluding the effect that the business cycle had on them is provided by an indicator called the fiscal stance. The fiscal stance is defined as the year-on-year change in the cyclically adjusted public finance balance. As with the fiscal impulse, we speak of tight, neutral or easy fiscal policy depending on the sign of the fiscal stance. Its value is not inputted into the CNB's modelling system, but does form part of the information supplied to the CNB Bank Board to support its decision-making (see Chart 2).

CHART 1 (BOX)
The fiscal impulse can be negative even with a government deficit

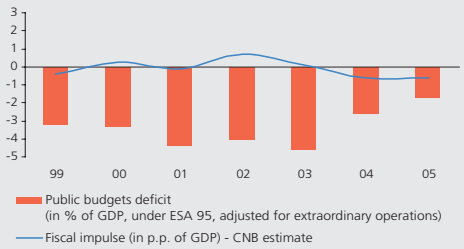
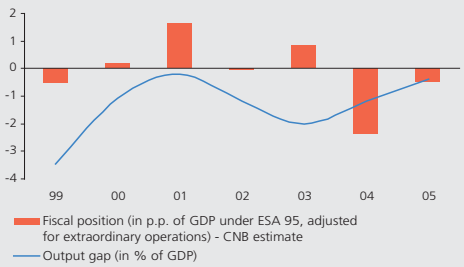


CHART 2 (BOX)
Fiscal policy is rather procyclical
(contributions of fiscal policy to GDP growth)



Another factor determining the message of the forecast consists of assumptions regarding the equilibrium values of key macroeconomic variables. These are used to derive the current position of the economy in the business cycle and the current settings of the monetary conditions, and their evolution at the same time provides the framework for the fundamental orientation of the forecast. They include, in particular, equilibrium real interest rates, the equilibrium real exchange rate and potential output (i.e. the non-accelerating inflation level of output). Among other things, analyses of past and present developments in economic activity, inflation, the exchange rate and interest rates are used to determine the starting conditions of the forecast and the equilibrium variables. This analysis draws on the linkages between these variables as perceived by the CNB's forecasting system.

The forecast continues to work with a non-accelerating inflation rate of output of around 4%, which is consistent with recent economic developments. However, the outlook for the relative effects of the interest rate and exchange rate components of the real monetary conditions has been changed compared to the last forecast. The equilibrium real appreciation has been increased slightly, so that the effect of the real exchange rate up until 2005 Q4 is not seen as tight, which better explains the observed exchange rate path. The forecast assumes a gradually decreasing pace of equilibrium real appreciation from the current level of just above 3%. At the same time, the estimate of domestic real equilibrium interest rates has been revised downwards to below 1%, and the past effect of the interest rate component of the monetary conditions is thus assessed as less easy. The lowering of the domestic real equilibrium rate path is consistent with the hypothesis that domestic real interest rates deflated by the consumer price index in a small open economy with a pronounced equilibrium exchange rate appreciation trend and a sufficiently low risk premium can be lower than abroad.

The information on economic activity published since the October forecast was prepared confirms the previous forecasts' vision of a continuing negative output gap. This is due to the slow economic growth abroad and the negative contribution of fiscal policy. The slightly easy impact of both components of the real monetary conditions and the assumption of continued buoyant growth at the end of the year led to an estimate of greater closure of the output gap in 2005 Q4 than expected in October. By the CNB's estimate, economic growth continued to be driven by net exports in 2005 H2, while the growth in fixed investment demand was generally lower in 2005 than a year earlier. The relatively low rate of growth of disposable income continued to hamper household consumption. The forecast expects a modest pick-up in disposable income growth at the close of the year, accompanied by a decrease in the gross saving rate and a gradual acceleration in private consumption. Except in Q3, government consumption was flat or falling year on year in 2005.

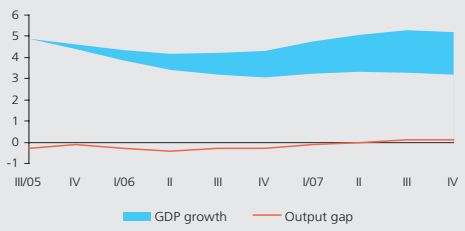
Consumer prices rose more slowly than October forecast expected at the close of the year. Although they continued to be pushed upwards by energy prices, other cost factors depressed consumer price inflation. Import prices excluding energy prices continued to record year-on-year declines, as did agricultural producer prices, which were one of the factors underlying the low food price inflation at the close of the year. Also fuel prices recorded a significant decline during Q4. The impacts of the changes to excise duty on cigarettes in July 2005 are still not very visible. The position of the economy in the business cycle also acted in the anti-inflationary direction.

The average settings of the real monetary conditions in 2005 Q4, which affect the course of the business cycle in the coming quarters, can be described overall as neutral to very slightly easy in both the interest rate and exchange rate components.

CHART IV.1

The output gap will close in the first half of 2007

(annual percentage changes; percentages of GDP; seasonally adjusted)



IV.3 THE MESSAGE OF THE FORECAST

The change in view regarding the equilibrium levels of domestic real interest rates and the real exchange rate, together with the change in the external economic outlook, leads to a partial revision of the projected evolution of GDP in 2006, the GDP structure and the output gap. Owing to low external demand and a tighter real exchange rate, expected as a result of appreciation of the nominal exchange rate and a positive inflation differential, the output gap will reopen slightly. This trend is expected to reverse at the turn of 2006 and 2007 as a consequence of slightly easy real monetary conditions, a positive contribution of fiscal policy and a moderate recovery abroad. These developments will be reflected in a slowdown in GDP growth in 2006 to an annual average of 3.9%, followed by an upturn to 4.3% in 2007.

In the quarters ahead, household consumption will continue to be affected by the cyclical improvement on the labour market, which will pass through to a pick-up in wages in the business sector despite the observed increase in employment of persons with lower wage requirements. However, real gross disposable income growth will be dampened by accelerating consumer price inflation and slow growth in non-wage income. The lagged effect of the slightly easy interest rate component in 2004 and 2005 will result in a further decline in the saving rate, which will keep the annual rate of growth of consumption above 3% this year. However, the positive stimuli from the labour market and real interest rates will weaken gradually amid a further moderate pick-up in inflation, which will, in turn, negatively affect real income. However, consumer spending inertia will lead to a further modest reduction in the gross saving rate in 2007, with the rate of growth of household consumption remaining at 2%. The revision of the forecast for the structure of the public budgets and the government consumption deflator was also reflected in the prediction for government consumption in 2006. Annual real growth in public sector consumer expenditure will be 1.1% this year, and an annual decrease of 0.5% is expected for 2007.

Growth in gross fixed capital formation will recover. Private investment will continue to rise amid neutral interest rates, thanks to a continuing improvement in export performance and inflow of foreign direct investment. Given the outlook for the public budgets, growth in public sector capital expenditure is also expected to regain pace. The average annual rate of growth of investment demand is estimated at 5.3% in 2006 and should increase slightly to 5.7% in 2007.

The growth trend in export performance, connected with the inflow of foreign direct investment, will continue into 2006 and 2007. For most of 2006, the effect of the modest recovery in external demand will be counteracted by annual appreciation of the nominal exchange rate. This will unwind in 2007, resulting in higher growth in real exports. The annual rate of growth will thus be only slightly below 10% in 2006 and increase to 12% in 2007. Growth in real imports will still lag behind export growth, but the lag will decrease. Underlying this trend will be the recent exchange rate developments and the pick-up in investment activity, with the latter gradually becoming the dominant factor. Import growth of 8.6% in 2006 and 11% in 2007 will remain consistent with a decline in the real net export deficit.

In 2006 and 2007, the forecast expects the nominal koruna-euro exchange rate to remain broadly stable at its end-2005 level. Underlying this stability are the contrary effects of the negative interest rate differential vis-à-vis the euro area and the long-term trend of equilibrium real appreciation, which should be partially asserted through the inflation differential.

The predicted inflation path is determined by the combined demand-pull pressures resulting from real economic activity, imported inflation and other exogenous factors. The inflation prediction for the short-term horizon has been revised downwards, reflecting the lower-than-expected inflation growth at the end of 2005 and the related revision of the estimated effects of the changes to excise duties on cigarettes and the fuel price inflation path in the near future. The forecast is also affected by the anti-inflationary effect of the nominal exchange rate. At the monetary policy horizon, however, expected inflation is similar to that predicted in the previous forecast and is close to the point inflation target.

The average inflation rate will be 2.8% in 2006 and rise to 3.6% in 2007. Underlying this will be rapid growth in regulated prices and the expected changes to indirect taxes (harmonisation changes to excise duties on tobacco products). As in the previous forecast, the pick-up in adjusted inflation is expected to be gradual, due chiefly to pass-through of the second-round effects of the growth in energy prices and regulated prices to other price categories and a moderate decrease in anti-inflationary pressures from the real economy. As in the previous forecast, only

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

	2006	2007
Real disposable income of households	1.7	1.1
Unemployment rate (in per cent)	9.3	9.2
Labour productivity	2.4	3.7
Current account deficit (ratio to GDP in per cent)	-1.9	-1.5
M2	6.9	6.3

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

	2006	2007
Gross domestic product	3.9	4.3
Household consumption	3.1	2.0
Government consumption	1.1	-0.5
Gross fixed capital formation	5.3	5.7
Imports of goods and services	8.6	11.0
Exports of goods and services	9.6	11.9
Net exports of goods and services (in CZK bn)	-123.0	-119.3

Chart IV.2
The inflation forecast is near the point inflation target at the monetary policy horizon
(annual percentage changes in CPI)

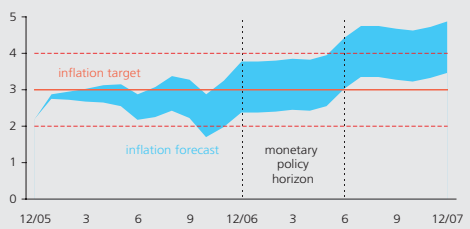
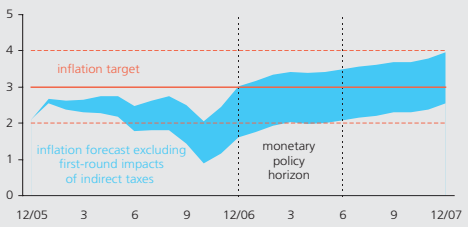


Table IV.4
Growth of inflation will be driven by regulated prices and changes to indirect taxes
(annual percentage changes)

	I/06	II/06	III/06	IV/06	I/07	II/07	III/07	IV/07
Annual consumer price inflation	2.8	2.8	2.8	2.7	3.1	3.4	4.0	4.0
Breakdown into contributions:								
regulated prices	10.9	10.7	8.9	5.0	4.0	3.8	3.8	3.9
indirect taxes (contributions in p.p.)	0.3	0.4	0.6	0.8	0.5	0.6	1.1	0.9
food prices, excluding changes to indirect taxes	-1.0	-0.6	-0.2	0.6	2.3	2.2	2.7	3.0
fuel prices, excluding changes to indirect taxes	12.5	0.3	-7.9	-7.9	-1.0	-1.6	-1.8	-1.5
adjusted inflation excluding fuels, excluding changes to indirect taxes	0.5	0.6	1.2	1.7	2.3	2.7	2.9	3.0

partial pass-through of the higher energy prices to other price categories is assumed. Import prices will have a neutral effect. Food prices will accelerate, primarily in response to the evolution of agricultural producer prices.

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



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 and is close to 3% at the end of 2007.

Consistent with the macroeconomic forecast and its assumptions is a gradual rise in interest rates, albeit to a lesser extent than assumed in the previous forecast. However, the current exchange rate developments and exchange rate expectations deviate from the forecasted trajectory. This shifts the risks of the forecast in an anti-inflationary direction. Sensitivity analyses have been performed showing that monetary policy can respond to a stronger koruna exchange rate with a decline in interest rates.

During the preparation of the forecast, an alternative scenario was drawn up which preserves the paths of the long-term equilibrium variables from the October forecast. By comparing this scenario with the baseline forecast scenario described above, some idea can be gained of the role of the equilibrium variables within the forecasting system and the effect of changes in their settings on the overall message of the forecast.

As in the baseline scenario, the economy is slightly below the non-accelerating inflation level of output in the alternative scenario. However, the initial effect of the monetary conditions is assessed as neutral to slightly tight, which, given a weak external recovery, will result in a greater widening of the negative output gap. The forecast for inflation is slightly lower by comparison with the baseline scenario, as the inflationary effects of the cost factors are partly offset by anti-inflationary pressures from the real economy. A gradual depreciation of the nominal exchange rate to CZK 30/EUR this year also helps to keep inflation close to the target. As a result of the different evolution of the nominal exchange rate, the slower equilibrium real appreciation and the higher policy-neutral interest rate, a gradually rising interest rate path that is somewhat steeper than in the baseline scenario is consistent with the scenario described above, despite the absence of demand-pull pressures.

IV.4 EXPECTATIONS OF ECONOMIC AGENTS

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

	12/04	9/05	10/05	11/05	12/05
Consumer price index					
1Y horizon:					
Financial market	2.8	2.5	2.7	2.8	2.6
Corporations	3.2	2.8			2.8
Households	1.5	5.2			4.6
3Y horizon:					
Financial market	2.8	2.5	2.5	2.6	2.5
Corporations	2.7	2.8			2.9
Households	1.8	5.7			5.2
1Y PRIBOR					
1Y horizon:					
Financial market	3.4	2.3	2.5	2.8	2.8

The inflation outturns expected by financial market participants increased slightly, although they remained below the CNB's inflation target. Analysts expect the cost shock at the start of 2006 to push inflation above 3%. After that, inflation is expected to return below the inflation target. The main upside risks to inflation still include regulated prices (gas, electricity, rents) and oil prices. By contrast, the expected appreciation of the koruna remains the main downside risk. The inflation expectations of corporations are unchanged. A fall in inflation expectations 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 anchored below the CNB's inflation target of 3% at this horizon, too.

Expected interest rates increased in the period under review at both the short and long ends of the yield curve. The interest rate path consistent with the aforementioned CNB forecast was, in the short term, broadly in line with the path expected by financial market analysts. At the longer horizon, the analysts' expectations were slightly lower.

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

A joint document of the Ministry of Finance of the Czech Republic, the Ministry of Industry and Trade of the Czech Republic and the Czech National Bank approved by the Government of the Czech Republic on November 23, 2005

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

Besides requiring the Member States to harmonise their legislation with Articles 108 and 109 of the Treaty establishing the European Community and the Statute of the ESCB and ECB, the EU legislation requires them to achieve a high degree of sustainable convergence as a precondition for joining the euro area. This is measured by the fulfilment of four convergence criteria: a high degree of price stability, as apparent from the rate of inflation; the long-term sustainability of the government financial position, as measured by the government deficit and government debt; exchange rate stability, as measured by movements in the exchange rate within the normal fluctuation margins of the ERM II system for two years without devaluation; and the durability of convergence as reflected in long-term interest rate levels. As an EU Member State, the Czech Republic is obliged to take steps to be prepared for joining the euro area as soon as possible. However, potential non-fulfilment of the convergence criteria has no consequences for the Czech Republic at present. The only exception is the criterion on the sustainability of public finances, which the Czech Republic has so far been unable to satisfy in a sustainable manner in the area of fiscal deficits. The state's fiscal performance is subject to multilateral surveillance of public finance developments. Failure to observe budgetary discipline led to the commencement of the excessive deficit procedure against the Czech Republic shortly after its accession to the EU. As a result, the Czech Republic has undertaken to reduce the government deficit in a sustainable manner to below 3% of GDP by 2008.

1.1 ASSESSMENT OF FULFILMENT OF THE CONVERGENCE CRITERIA

The Czech Republic is currently compliant with **the criterion on price stability**. The CNB's inflation target for the national consumer price index for the period starting 2006 has been set at 3%. The CNB has at the same time undertaken to endeavour to ensure that actual inflation does not differ from this target by more than one percentage point in either direction. This target creates conditions for the fulfilment of the criterion near its reference value, provided that inflation in the EU Member States does not deviate too far downwards from the ECB's definition of price stability (inflation "below, but close to 2%"). However, the possibility of non-fulfilment of this criterion cannot be ruled out in the case of unforeseen events with a strong inflationary effect or disinflationary shocks in EU Member States leading to a reduction in the reference value.

The Czech Republic is not compliant with **the criterion on the sustainability of the government financial position**. According to the draft 2005 Convergence Programme, a sustainable decrease in the public budgets deficit to below 3% of GDP can be expected from 2008 onwards. This constitutes a major limitation with respect to the timing of euro adoption. The government debt is still relatively low (despite the present upward trend) compared to the reference value of 60% of GDP. Provided that the draft 2005 Convergence Programme is implemented, there should be no danger of non-fulfilment of either component of this criterion as from 2008.

Formal assessment of the **exchange rate criterion** will only be possible after the Czech Republic joins ERM II and announces the central parity for the koruna's exchange rate within this mechanism. Moreover, this criterion should not be interpreted mechanically, but in relation to other economic fundamentals and their impact on any exchange rate fluctuations. The fluctuations in the CZK/EUR exchange rate over the last few years have been distinctly smaller than the hypothetical band of ±15%. Nonetheless, the deviations from the average rate have been quite significant. The koruna has been showing an appreciation trend for some time. At present, therefore, we cannot say for sure whether the past developments would have been assessed as compliant with the condition of movement close to the central parity "without severe tensions".

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

1.2 ASSESSMENT OF ECONOMIC ANALYSES

There are numerous indicators that traditionally speak in favour of relatively early adoption of the euro. These include in particular the high degree of openness of the Czech economy, its close trade and ownership links with the euro area, and the achievement of convergence in the inflation rate and nominal interest rates.

In addition, there are some indicators which tended to be unfavourable for the Czech Republic in the past, but which have improved in recent years. These include, for example, GDP per capita, where the Czech Republic is slowly approaching the least advanced countries of the monetary union, and financial sector stability, which has shown a partial improvement.

Long-term stabilisation of public budgets below the 3% reference value and labour market reforms are traditional bottlenecks that will require further efforts prior to euro area entry. The labour market is still characterised by relatively high long-term and structural unemployment, low regional mobility, high costs of terminating employment contracts in the event of their being of short duration, and low motivation for low-income groups to seek jobs. Some positive changes have been introduced recently, for example the introduction of tighter conditions for qualifying for unemployment benefit and easier procedures for setting up businesses. Besides fiscal reforms, greater labour market flexibility is still one of the key challenges going forward.

1.3 RECOMMENDATIONS

Based on the aforementioned analyses and in line with the earlier approved euro adoption strategy, the Ministry of Finance, the Ministry of Industry and Trade and the Czech National Bank recommend that the Czech Government should **not attempt to enter the ERM II during 2006.**

The reason is that the conditions have yet to be created for the Czech Republic to meet the requirements for joining the euro area two years after entering the ERM II and to be able to benefit from adopting the euro. Any future change regarding this recommendation depends primarily on progress with the public finance reform and other reforms directed at increasing the flexibility of the Czech economy, and particularly that of the labour market.

2 ASSESSMENT OF THE CURRENT AND EXPECTED FULFILMENT OF THE MAASTRICHT CONVERGENCE CRITERIA

The convergence criteria (price stability, the public finance sustainability measured by the government deficit and government debt, exchange rate stability, and the durability of convergence based on long-term interest rates) are defined in the EC Treaty (hereinafter referred to as the "Treaty") and specified in the Protocol on the convergence criteria and the Protocol on the excessive deficit procedure annexed to the Treaty. Fulfilment of the convergence criteria in a sustainable, not only one-off, manner is a necessary condition for adoption of the single currency by a Member State with a derogation.

2.1 CRITERION ON PRICE STABILITY

BOX 2.1: DEFINITION OF THE CRITERION ON PRICE STABILITY

Treaty provisions
The first indent of Article 121 (1) of the Treaty requires: "the achievement of a high degree of price stability; this will be apparent from a rate of inflation which is close to that of, at most, the three best performing Member States in terms of price stability".

Article 1 of the Protocol on the convergence criteria referred to in Article 121 of the Treaty stipulates that: "the criterion on price stability referred to in the first indent of Article 121 (1) of this Treaty shall mean that a Member State has a price performance that is sustainable and an average rate of inflation, observed over a period of one year before the examination, that does not exceed by more than 1.5 percentage points that of, at most, the three best performing Member States in terms of price stability. Inflation shall be measured by means of the consumer price index on a comparable basis, taking into account differences in national definitions."

Application of Treaty provisions
With regard to "an average rate of inflation, observed over a period of one year before the examination", the inflation rate is calculated using the increase in the latest available 12-month average of the Harmonised Index of Consumer Prices (HICP) over the previous 12-month average.

The notion of "at most, the three best performing Member States in terms of price stability", which is used for the definition of the reference value, is applied by using the unweighted arithmetic average of the rate of inflation in the three countries with the lowest inflation rates, given that these rates are compatible with price stability.[1]

Source: European Central Bank, European Commission

[1] The specific implementation of this interpretation in the latest EC Convergence Report (2004) differs somewhat from the interpretation in the latest ECB Convergence Report (2004). Both reports work with the three countries with the lowest inflation (Finland, Denmark and Sweden) excluding Lithuania, which recorded an inflation rate of -0.2% in the reference period. However, the decision to exclude Lithuania is justified in slightly different ways. For the Commission the reason is that Lithuania showed negative inflation, whereas for the ECB it is that the price developments in Lithuania over the reference period were judged to be due to the accumulation of specific factors; in the ECB's opinion, including such factors in the calculation of the reference value might have distorted the reference value and reduced its usefulness as an economically meaningful benchmark.

The Czech Republic has been compliant with the criterion on price stability since 2002. The only exception was 2004, when inflation increased temporarily owing to changes to indirect taxes and a simultaneous decrease in the reference value due to exceptionally low inflation in some EU countries. According to the current forecast on which the Czech Republic's Convergence Programme is based and to the inflation outlook for EU Member States, there should be no danger of non-fulfilment of this criterion in the future, either (see Table 2.1).

Table 2.1: Harmonised Index of Consumer Prices
(average for last 12 months vs. average for previous 12 months, growth in %)

	2002	2003	2004	8/2005	2005	2006	2007	2008
Average for 3 EU countries with lowest inflation	1.4	1.2	0.7	0.9	0.9	1.3	1.3	1.3
Reference value (1st line +1.5 p.p.)	2.9	2.7	2.2	2.4	2.4	2.8	2.8	2.8
Czech Republic*	1.4	-0.1	2.6	1.8	1.5	2.2	2.0	2.1

Source: Eurostat, European Commission, Convergence Programmes and Stability Programmes of Member States, draft Convergence Programme of the Czech Republic (2005)

Note: The outlook for inflation in the European Union for 2005–2006 is taken from the European Commission's spring economic forecast and that for 2007–2008 from the Member States' Convergence Programmes and Stability Programmes (2004).
*) The forecast for the Czech Republic is taken from the draft Convergence Programme of the Czech Republic (2005), prepared using the data available in September 2005. The CNB's October 2005 forecast expects HICP inflation of 1.7% in 2005, 3.3% in 2006 and 3.1% in 2007.

The definition of "at most, the three best performing Member States in terms of price stability" provides some latitude in the assessment of the criterion with respect to which states might be excluded from the calculation of the reference value owing to their inflation rate not being considered "compatible with price stability". The calculation of the reference value in Table 2.1 uses the interpretation where the three best performing countries in terms of price stability are the countries with the lowest positive inflation.

The outlook for the reference value derived from the inflation forecasts in individual Member States shows an upward tendency compared to 2004. This is not consistent, however, with the flat inflation expected in the EU. This expectation reflects the far lower degree of variability in the inflation forecasts of the individual Member States, which, with only some exceptions, do not contain values deviating markedly from the ECB's inflation target. The degree of variability of the inflation forecasts is thus lower than that displayed by the historical data, hence the actually measured inflation rates can be expected to show a greater level of differentiation than the inflation forecasts. This can clearly also mean a lower inflation rate in the key countries for the calculation of the criterion, and hence a lower reference value.

If we derive the outlook for the reference value from past data, in 1999-2004 the criterion ranged between 2.2% and 2.9%. The CNB's inflation target for the national consumer price index for the period starting 2006 has been set at 3%[2] (the CNB has at the same time undertaken to endeavour to ensure that actual inflation does not differ from this target by more than one percentage point in either direction). This target thus creates conditions for the fulfilment of the criterion near its reference value. The HICP in the Czech Republic has systematically recorded lower inflation levels than the national index[3]. Nonetheless, in 2004, for example,

[2] For details, see the document "The CNB's inflation target from January 2006" of 11 March 2004, which is available at http://www.cnb.cz/en/monetary_policy/strategic_documents/download/mp_cil_2006_a.pdf

[3] There are some differences in structure between the consumer basket of the Czech Republic's national consumer price index and that of the HICP. The HICP weights include revenues from purchases by foreigners in the Czech Republic, but do not include hypothetical rents, whereas the national consumer price index does not include revenues from purchases by foreigners, but does include hypothetical rents. Owing to this difference in basket composition, the HICP inflation rate is on average 0.3 percentage point lower than the national CPI inflation rate.

disinflationary shocks in some EU countries resulted in a reduction in the reference value, whereas inflation in the Czech Republic recorded a temporary increase, meaning that the Czech Republic was non-compliant with the price stability criterion for a short time. Obviously, non-compliance with the criterion for a time, especially due to external developments, cannot be ruled out in the future, either.

2.2 CRITERION ON THE SUSTAINABILITY OF PUBLIC FINANCES [4]

Government deficit criterion

The first part of the criterion on the sustainability of public finances is focused on short-term to medium-term fiscal developments. The benchmark is the general government deficit under ESA 95 national accounts methodology. The current settings of the Czech Republic's public finance parameters prevent it from satisfying the government deficit criterion in a sustainable manner. The outlook for the period ahead suggests that the temporary decline in the deficit to 3% of GDP in 2004 cannot be regarded as sustainable. The ongoing consolidation of public finances is aimed at gradual reducing the government deficit. Provided that the reform continues successfully, fulfilment of the convergence criterion can be expected in 2008 (see Table 2.2).

Table 2.2: Government deficit
(ESA 1995 methodology, in % of GDP

	2002	2003	2004	2005	2006	2007	2008
Reference value	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0
Czech Republic*	-6.8	-12.5	-3.0	-4.8	-3.8	-3.3	-2.7

Source: CZSO, draft Convergence Programme of the Czech Republic (2005)

*) The forecast for the Czech Republic is taken from the draft Convergence Programme of the Czech Republic (2005), prepared using the data available in September 2005. The CNB's October 2005 forecast expects a public finance deficit of 3.6% of GDP in 2005, 3.0% of GDP in 2006 and 2.8% of GDP in 2007.

BOX 2.2: DEFINITION OF THE CRITERION ON THE SUSTAINABILITY OF THE GOVERNMENT FINANCIAL POSITION

Treaty provisions
The second indent of Article 121 (1) of the Treaty requires: "the sustainability of the government financial position; this will be apparent from having achieved a government budgetary position without a deficit that is excessive, as determined in accordance with Article 104 (6)".

Article 2 of the Protocol on the convergence criteria referred to in Article 121 of the Treaty stipulates that this criterion "shall mean that at the time of the examination the Member State is not the subject of a Council Decision under Article 104 (6) of this Treaty that an excessive deficit exists".

Article 104 of the Treaty sets out the excessive deficit procedure. According to Article 104 (2) and (3), the European Commission prepares a report if a Member State does not fulfil the requirements for fiscal discipline, in particular if:

1. the ratio of the planned or actual government deficit to GDP exceeds a reference value (defined in the Protocol on the excessive deficit procedure as 3% of GDP), unless:

[4] The criterion on the sustainability of public finances is satisfied only when both fiscal criteria, i.e. the government deficit and government debt, are fulfilled in a sustainable manner.

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

2. the ratio of government debt to GDP exceeds a reference value (defined in the Protocol on the excessive deficit procedure as 60% of GDP), unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.

Other Treaty provisions - Excessive deficit procedure
The report prepared by the European Commission under Article 104 (3) of the Treaty should also take into account whether the government deficit exceeds government investment expenditure and all other relevant indicators, including the medium-term economic and budgetary position of the Member State.

The Commission may also prepare a report if, notwithstanding the fulfilment of the criteria, it is of the opinion that there is a risk of an excessive deficit in a Member State. The Economic and Financial Committee formulates an opinion on the Commission's report.

In accordance with Article 104 (6), the EU Council, on the basis of a recommendation from the Commission and having considered any observations which the Member State concerned may wish to make, decides, acting by qualified majority and following an overall assessment, whether an excessive deficit exists in a Member State. Under Article 104 (7) of the Treaty, the EU Council then makes recommendations to the Member State concerned with a view to bringing the deficit below the 3% level within a given period.

Source: European Central Bank, European Commission

Government debt criterion

The second part of the criterion monitors the sustainability of public finances from a longer-term perspective based on the level and trend of the general government debt. Given its low initial level of government debt, the Czech Republic has no problem fulfilling this criterion. The government debt growth in recent years largely reflects the inclusion of the majority of the indirect liabilities of the government (particularly government guarantees and the sectorisation of Česká inkasní, the Czech Consolidation Agency and their subsidiaries in the general government sector). The rate of growth in debt is slowing thanks to the public finance reform. Successful completion of the fiscal consolidation should stabilise the government debt level safely below the reference level (see Table 2.3).

Table 2.3: Government debt
(ESA 1995 methodology, in % of GDP)

	2002	2003	2004	2005	2006	2007	2008
Reference value	60.0	60.0	60.0	60.0	60.0	60.0	60.0
Czech Republic*	29.8	36.8	36.8	37.4	37.1	37.9	37.8

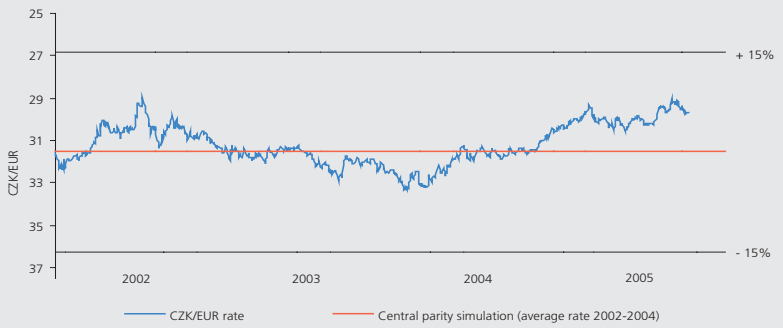
Source: CZSO, draft Convergence Programme of the Czech Republic (2005

*) The forecast for the Czech Republic is taken from the draft Convergence Programme of the Czech Republic (2005), prepared using the data available in September 2005. The CNB's October 2005 forecast expects a government debt of 35.8% of GDP in 2005, 36.1% of GDP in 2006 and 36.7% of GDP in 2007.

2.3 CRITERION ON EXCHANGE RATE STABILITY

The Czech Republic does not participate in ERM II, so the central parity of the CZK/EUR rate has not been set yet. For this reason, the exchange rate criterion cannot be formally assessed. In Chart 2.1, the central parity is, for illustration, assumed to be the average of the daily rates for 2002-2004.

Chart 2.1: Nominal CZK/EUR rate



Source: CNB

Note: In the chart, an upward movement in the exchange rate means an appreciation of the koruna. The hypothetical central parity is simulated by the average rate for 2002-2004.

The fluctuations in the CZK/EUR exchange rate over the last few years have been distinctly smaller than the hypothetical band of ±15%. Nonetheless, the deviations from the average rate have been quite significant. The koruna has been showing an appreciation trend for some time. The definition of the criterion implies that its interpretation is not entirely clear and that the assessment of fulfilment of this criterion will take also into account other factors than the exchange rate level alone. We cannot therefore say for sure whether the present situation would be assessed as compliant with the condition of movement close to the central parity "without severe tensions".

BOX 2.3: DEFINITION OF THE CRITERION ON EXCHANGE RATE STABILITY

Treaty provisions

The third indent of Article 121 (1) of the Treaty requires: "the observance of the normal fluctuation margins provided for by the exchange-rate mechanism of the European Monetary System, for at least two years, without devaluing against the currency of any other Member State".

Article 3 of the Protocol on the convergence criteria referred to in Article 121 (1) of the Treaty stipulates that: "the criterion on participation in the exchange-rate mechanism of the European Monetary System referred to in the third indent of Article 121 (1) of this Treaty shall mean that a Member State has respected the normal fluctuation margins provided for by the exchange-rate mechanism of the European Monetary System without severe tensions for at least the last two years before the examination. In particular, the Member State shall not have devalued its currency's bilateral central rate against any other Member State's currency on its own initiative for the same period."

Application of Treaty provisions
The Treaty refers to the criterion of participation in the European exchange-rate mechanism (ERM until December 1998 and ERM II since January 1999).

First, the ECB assesses whether the country has participated in ERM II "for at least the last two years before the examination", as stated in the Treaty.

Second, as regards the definition of "normal fluctuation margins", the ECB recalls the formal opinion that was put forward by the EMI Council in October 1994 and its statements in the November 1995 report entitled "Progress towards Convergence".

The EMI Council's opinion of October 1994 stated that "the wider band has helped to achieve a sustainable degree of exchange rate stability in the ERM", that "the EMI Council considers it advisable to maintain the present arrangements", and that "member countries should continue to aim at avoiding significant exchange rate fluctuations by gearing their policies to the achievement of price stability and the reduction of fiscal deficits, thereby contributing to the fulfilment of the requirements set out in Article 121 (1) of the Treaty and the relevant Protocol".

In the November 1995 report entitled "Progress towards Convergence" it was stated that "when the Treaty was conceived, the 'normal fluctuation margins' were ±2.25% around bilateral central parities, whereas a ±6% band was a derogation from the rule. In August 1993 the decision was taken to widen the fluctuation margins to ±15%, and the interpretation of the criterion, in particular of the concept of 'normal fluctuation margins', became less straightforward". It was then also proposed that account would need to be taken of "the particular evolution of exchange rates in the European Monetary System (EMS) since 1993 in forming an ex post judgement".

Against this background, in the assessment of exchange rate developments the emphasis is placed on exchange rates being close to the ERM II central rates.

Third, the issue of the presence of "severe tensions" or "strong pressures" on the exchange rate is addressed by examining the degree of deviation of exchange rates from the ERM II central rates against the euro. Other indicators, such as short-term interest rate differentials vis-à-vis the euro area and their evolution, are used as well. The role played by foreign exchange interventions is also considered.

Source: European Central Bank, European Commission

Successful participation in ERM II depends in particular on the degree of alignment with the euro area economy, on market flexibility and on the consistency of economic policies. The euro-strategy recommends participation in ERM II for the minimum required period of two years only. This implies that "the Czech Republic should enter the ERM II only after conditions have been established which enable it to introduce the euro at the time of the assessment of the exchange rate criterion and to then benefit from its introduction without experiencing any problems".[5]

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

[5] For details, see the joint document of the CNB and the Czech Government entitled "The Czech Republic's Euro-area Accession Strategy" at http://www.mfcr.cz/cps/rde/xchg/mfcr/hs.xsl/eu_acc_stra_13438.html

2.4 CRITERION ON LONG-TERM INTEREST RATES

BOX 2.4: DEFINITION OF THE CRITERION ON LONG-TERM INTEREST RATES

Treaty provisions
The fourth indent of Article 121 (1) of the Treaty requires: "the durability of convergence achieved by the Member State and of its participation in the exchange-rate mechanism of the European Monetary System being reflected in the long-term interest-rate levels".

Article 4 of the Protocol on the convergence criteria referred to in Article 121 (1) of the Treaty stipulates that: "the criterion on the convergence of interest rates referred to in the fourth indent of Article 121 (1) of this Treaty shall mean that, observed over a period of one year before the examination, a Member State has had an average nominal long-term interest rate that does not exceed by more than 2 percentage points that of, at most, the three best performing Member States in terms of price stability. Interest rates shall be measured on the basis of long-term government bonds or comparable securities, taking into account differences in national definitions."

Application of Treaty provisions
First, with regard to "an average nominal long-term interest rate" observed over "a period of one year before the examination", the long-term interest rate has been calculated as an arithmetic average over the latest 12 months for which HICP data were available.

Second, the notion of "at most, the three best performing Member States in terms of price stability" which is used for the definition of the reference value has been applied by using the unweighted arithmetic average of the long-term interest rates in the three countries with the lowest inflation rates. Interest rates have been measured on the basis of harmonised long-term interest rates, which were developed for the purpose of assessing convergence.

Source: European Central Bank (ECB)

The Czech Republic is currently compliant with the criterion on long-term interest rates and no problems are expected in this area in the future[6] (see Table 2.4).

Table 2.4: 10-year interest rates on government bonds on the secondary market
(average for the last 12 months, in %)

	2002	2003	2004	7/05	2005	2006	2007	2008
Average for 3 countries with lowest inflation	4.90	4.12	4.28	3.76	3.8	4.2	4.2	4.2
Reference value (1st line + 2.0 p.p.)	6.90	6.12	6.28	5.76	5.8	6.2	6.2	6.2
Czech Republic	4.94	4.12	4.75	4.01	3.3	3.4	3.9	4.0

Source: Eurostat, Macroeconomic Forecast of the Czech Ministry of Finance (October 2005)

The forecast for interest rates on government bonds in the Czech Republic is dependent on the successful completion of the public finance consolidation. Any loss of financial market confidence in the outcome of the fiscal reform could very quickly pass through into a rise in the risk premium on long-term interest rates and endanger the fulfilment of this convergence criterion.

[6] As no forecast for the time horizon under review is available for the long-term interest rates of the countries that should, according to the inflation forecast, form the basis for calculating the criterion, the projection of the reference value in Table 2.4 is based on the technical assumption that long-term interest rates will move in line with inflation, i.e. real interest rates will not change. The reference value in 2005-2008 should therefore be viewed as only tentative.

3 ASSESSMENT OF THE CZECH REPUBLIC'S CURRENT ECONOMIC ALIGNMENT WITH THE EURO AREA

This part summarises the results of a set of analyses directed at assessing the Czech economy's alignment with the euro area over and above the formal criteria whose fulfilment is assessed in the previous part. Entry into the euro area will fundamentally change the Czech economy's possibilities for adjusting to economic shocks. There will be no possibility of adjusting to the euro area countries, i.e. the Czech Republic's biggest trading partners, through movements in the exchange rate. Monetary policy will be formulated at the euro area level; hence, there will be a risk of the monetary conditions not corresponding to the situation in the Czech economy at any given moment. Therefore, it is important to examine how big this risk is and how well the Czech economy will be able to respond if it materialises.

The analyses are divided into two basic groups by the type of question which they try to answer. The section entitled "Cyclical and Structural Alignment" indicates the size of the risk of economic shocks whose impact on the Czech economy will differ from that on the euro area as a whole ("asymmetric shocks"). The section entitled "Adjustment Mechanisms" answers the question of to what extent the Czech economy is capable of absorbing the impacts of possible asymmetric shocks. The basic theoretical starting point for the underlying analyses is the theory of optimum currency areas. These analyses are aimed at assessing the evolution of the alignment indicators over time and in comparison with selected countries which either are euro area members already (Austria, Portugal and Greece[7] were selected) or aspire to such membership (Poland, Slovakia and Hungary).[8] The conclusion as to whether the Czech economy is sufficiently prepared for adopting the single currency cannot be made in absolute terms, but can ensue from the aforementioned comparison with other countries and the assessment of developments over time. In general, it can be expected that the benefits of adopting the single currency will grow with greater economic alignment and stronger adjustment mechanisms.

3.1 Cyclical and Structural Alignment

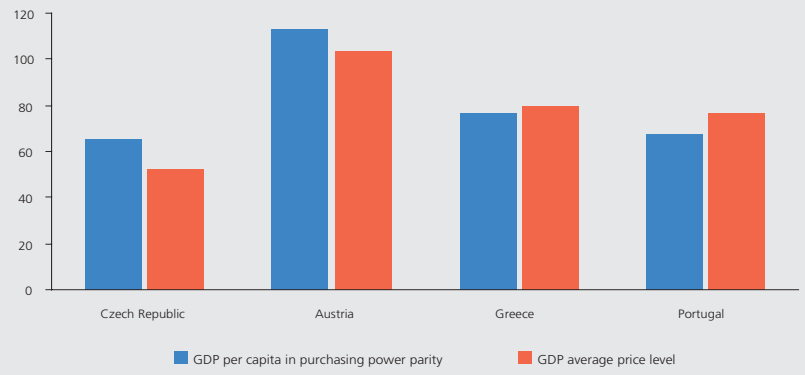
The costs arising from the loss of the Czech Republic's own monetary policy will be particularly felt if the Czech economy is not aligned with the euro area economy and its develoment, therefore, deviates frequently from that in the euro area. The risks arising from the Czech Republic's accession to the euro area will decrease as the degree of alignment increases.

The degree of real economic convergence is a fundamental indicator of the economy's similarity to the euro area. A higher degree of convergence prior to ERM II entry and euro adoption will decrease the potential pressures stemming from price level convergence and appreciation of the real exchange rate. In terms of GDP per capita, the Czech Republic is slowly approaching the least advanced countries, while it is lagging in price level (see Chart 3.1). Going forward, we can expect a real appreciation of the koruna against the euro of 2%–3% year on year, with a gradually declining tendency. In the presence of a persisting need for a high rate of real appreciation of the koruna after joining the euro area, we can expect rather higher domestic inflation than average inflation in the euro area and, as a result, lower real interest rates than the average for the euro area. Were this situation to persist in the long term, it could pose a certain risk.

[7] The euro area countries were selected so as to include countries that are comparable in terms of economic level and countries with which the Czech economy has trading links.

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

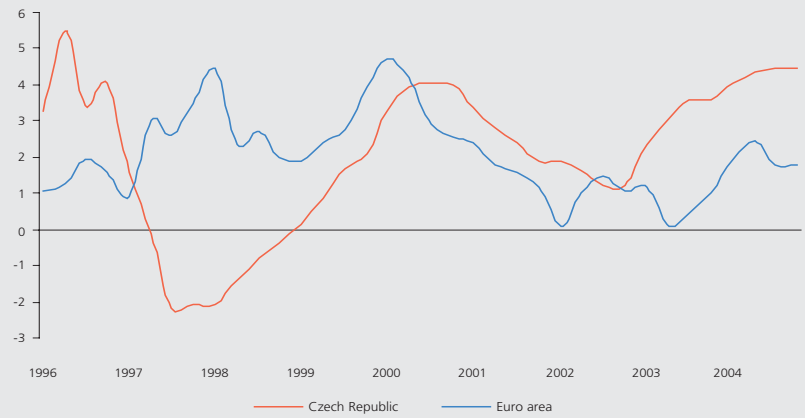
Chart 3.1: Real economic convergence of selected states towards euro area in 2004
(euro area average = 100)



Source: Eurostat, CNB calculation

Sufficient **alignment of the business cycle and similarity of economic shocks** are preconditions for a single monetary policy to have an effective and appropriate effect on an economy in a monetary union. Statistical calculations for the period 1995-2004 show that the alignment of the business cycle of the Czech economy with the euro area has been increasing since 1999 (see Chart 3.2). However, this trend is not very robust so far.[9]

Chart 3.2: GDP growth in the Czech Republic and the euro area
(in %, year on year)



Source: Eurostat, CNB calculation

An **analysis of the potential impacts of the increased inflow of money from EU structural funds**, which could generate a short-term fiscal impulse for domestic demand, formed part of the analyses conducted. According to current forecasts, this impulse should peak in 2007 and 2008. The analysis reveals that monetary policy, if

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

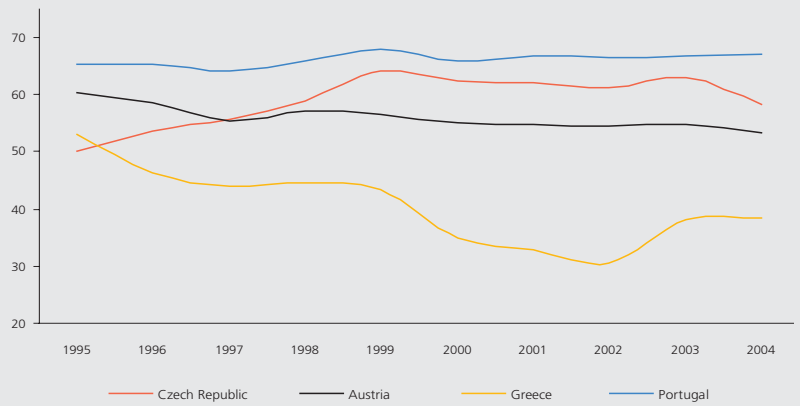
co-ordinated with other macroeconomic policies, can help to deal with the macroeconomic impacts of this inflow using standard instruments, and that the risk of large movements in interest rates, exchange rate and inflation might arise only in the event of other simultaneous shocks acting in the same direction.

The structure of the Czech economy in terms of product creation is broadly similar to that of the euro area economy, although it retains a specific feature in the form of a higher share of industry at the expense of services. However, the Czech economy has a lower (and slowly falling) degree of structural similarity compared to some countries (e.g. Hungary, Portugal and Austria).

Nominal interest rates in the Czech Republic do not differ significantly from those in the euro area. Czech interest rates have been close to, or lower than, euro area rates since 2002. The economy would thus not suffer a shock by moving to the single monetary policy. In the other new member states monitored, the difference in interest rates is distinctly larger. In recent years, the **koruna's exchange rate** against the dollar has been moving similarly to the euro's exchange rate against the dollar. This reflects the absence of major asymmetric pressures. Of the other Central European countries monitored, only Slovakia has a similarly strong link between its domestic currency and the euro.

The high degree of **openness of the Czech economy** to the euro area is the principal argument for adopting the single currency. The share of exports and imports of goods and services from the euro area in total Czech exports and imports has been fluctuating around 60% since the end of the 1990s (see Chart 3.3). Austria and Portugal, i.e. the countries included in the comparison apart from Greece, have a similar degree of openness to the euro area. The Czech economy's ownership links with the euro area are also relatively high by comparison with other countries. The existence of strong economic integration creates conditions for future convergence of the business cycles in the Czech economy and the euro area and for a decline in the probability of asymmetric shocks. The high openness of the Czech economy also increases the potential benefits arising from the elimination of potential exchange rate fluctuations vis-à-vis our main trading partners. Another positive aspect is the share of intra-industry trade between the Czech Republic and the EU, which is quite high relative to the EU Member States included in the comparison.

Chart 3.3: Exports to the euro area as a percentage of total exports
(in %)



Source: IMF (Direction of Trade Statistics), CNB calculation

Differences in **financial intermediation** may cause similar shocks – and the ECB's subsequent single monetary policy measures – to have different impacts on different economies. An unstable financial sector may also be a source of shocks itself. The relative size of the financial sector in the Czech Republic, as measured by the ratio of assets to GDP, is roughly two-fifths of that in Austria and Portugal and the euro area average. A more detailed look reveals that the Czech Republic is lagging behind the euro area countries in lending. By comparison with Austria and Portugal, the volume of loans in relative terms (including the government sector) is up to three times lower. However, the Czech Republic has the most developed financial intermediation system of the new Member States included in the comparison. The qualitative indicators attest to the maintenance of financial stability in the Czech Republic.

Overall, we can say that the financial sector is prepared for smooth functioning in the euro area, with strong ownership links to European banks and a standard range of financial services. The financial sector's openness to, and integration with, European markets may to some extent lower the costs incurred by economic agents due to the existence of independent monetary policy. The rapid increase in lending and in particular the fast growth in loans to households are attracting attention as regards financial stability. The banking sector should be capable of handling these processes provided that the related risks are managed in a prudent manner, in particular with respect to the rate of growth of total household debt.

3.2 ADJUSTMENT MECHANISMS

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

Compliance with the Maastricht criteria on the government deficit and debt is only one dimension in assessing whether **the public finances of the Czech Republic** are capable of functioning within the European fiscal regulations. From the macroeconomic point of view, it is vital to take into account whether sufficient room has been created for the stabilisation function of public budgets. The ability to respond via public finances to any negative exogenous shocks will be determined by the distance of the current deficit from the 3% reference value. The more the government can reduce the government sector deficit towards zero, especially in its structural part, the more room it will have for the functioning of automatic stabilisers and, in the extreme case, also for implementing active discretionary fiscal policy. Emphasis should be placed, above all, on creating government sector surpluses in periods of high economic growth. Continuing consolidation of Czech public finances is an important factor not only as regards future fulfilment of the Maastricht criterion on the public budget deficit, but also for creating room for the stabilisation function of public budgets after the country joins the euro area.

The growth in nominal public debt, despite the expected stabilisation of its share in GDP, has in recent years led to growing debt service costs. This could reduce the room for the stabilising function of public budgets. Achieving long-term sustainability of public finances, especially by dealing with the effect of population ageing on the social system, is a challenge for maintaining fiscal policy effectiveness.

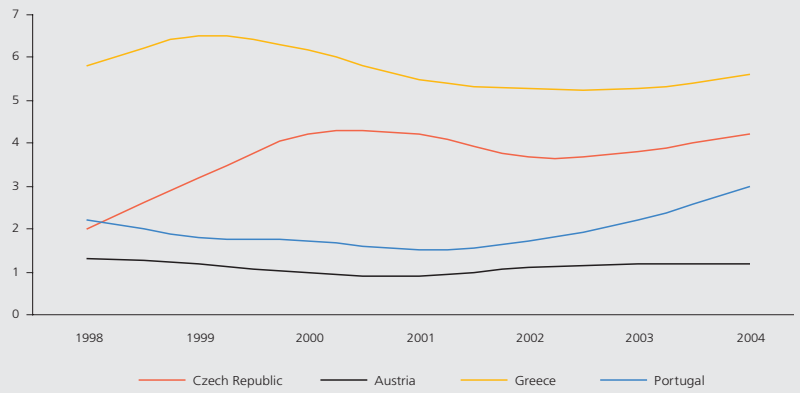
Price and wage flexibility is an important precondition for the economy to be able to absorb shocks to which the single monetary policy cannot respond. The analyses show that the flexibility of real wages in the Czech Republic is similar to that in most of the countries included in the comparison (i.e. Hungary, Poland and Slovakia), although it seems to have been falling somewhat over time. Lower flexibility by comparison with the other countries is also observed for prices.

The ability of the Czech labour market to absorb shocks is average by European comparison (this, however, may be a fairly low standard, because the European labour market is itself going through a period where there is a need for structural reforms). Nevertheless, in some areas the labour market is considerably less flexible and the monitored indicators suggest a risk of further deterioration. The institutional rules on the labour market still handicap above all people with low skills. The main risk factors are the interaction of taxes and social benefits, the costs of dismissing employees having open-ended employment contracts, and a rising minimum wage.

The labour market is still characterised by relatively high long-term and structural unemployment (see Chart 3.4). Although long-term unemployment is still a smaller problem than in some other countries (particularly Poland, Slovakia and Greece), the regional differences in unemployment in the Czech Republic are quite large by comparison with other countries. This may be due to significant regional gaps between the demand for, and supply of, labour and the low regional mobility of the labour force. The relatively low mobility within the Czech Republic suggests the likelihood of low international mobility and therefore it cannot be relied on as an adjustment mechanism. Moreover, international mobility within the European Union is administratively restricted for the new EU members in most of the original Member States.

Labour market flexibility is to a great extent determined by institutional rules. The effect of collective pay agreements on wage setting is relatively low in the Czech Republic by comparison with other countries. According to the comparisons performed, the impact of the minimum wage on the flexibility of low wages and on job creation is lower on average in the Czech Republic than in some other countries. Employment protection can have an adverse effect on the demand for labour. The costs of terminating an open-ended employment contract in the event of it being of short duration are relatively high.

Chart 3.4: Long-term unemployment: ratio of persons unemployed for more than one year to the labour force
(in %)



Source: Eurostat

Overall labour taxation is also high in the Czech Republic; this could be another risk factor for labour market flexibility should the cost of labour rise to the level usual in EU countries. Compared to other countries, the Czech Republic also continues to have relatively high taxation of people with low skills. Thanks to tighter conditions

for qualifying for unemployment benefit and social benefits, the motivation to seek employment seems to have improved slightly, although the system of taxes and social benefits has not been fundamentally changed. Some improvement has been recorded in the regulation of the business environment, with the introduction of easier procedures for setting up businesses in 2005. This may positively affect job creation and thereby improve labour market flexibility. However, by international comparison, entrepreneurship in the Czech Republic is still hampered by major administrative obstacles.[10]

Stability and profitability of the financial sector is a precondition for the sector to be able to assist in eliminating the impacts of economic shocks.[11] Recent years have seen privatisation-related and state-supported clean-ups of banks' balance sheets and improvements in their credit portfolios. As of the end of 2004, the Czech banking sector had better-quality loan portfolios than Poland, Slovakia and Greece. The coverage of non-performing loans by provisions in the Czech banking sector is comparable to that in the euro area. The capital adequacy ratio of the Czech banking sector (12.6% in 2004) indicates sufficient coverage of the potential risks. The sector's resilience is enhanced by its high profitability. The banking sector as a whole has secured its stability and maintained its ability to absorb potential shocks, as evidenced by the results of statistical simulations called "stress tests".

[10] An OECD index was used to compare the aforementioned administrative obstacles - see the 2005 study entitled "Product Market Regulation in OECD Countries, 1998 to 2003".

[11] The stability and profitability of the financial sector were examined using data on the situation in the banking sector. This approach was used because of the banking sector's decisive weight in the financial sector, the scope of supervision and the availability of relevant data for the international examination.

MINUTES OF THE BOARD MEETING ON 24 NOVEMBER 2005

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

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

Annual inflation had risen to 2.6% in October. This rise was in line with the current forecast. As regards the structure of consumer price inflation, slightly higher-than-forecasted growth in administered prices had been recorded, offset by rather lower-than-forecasted growth in food prices and fuels. Adjusted inflation excluding fuels had been consistent with the forecast. The current rise in industrial producer prices and import prices was slightly lower than forecasted. Agricultural producer prices in September had been pretty much in line with the forecast.

The new figures on the real economy indicated no major risks to the fulfilment of the forecast, which expects third-quarter GDP growth of just under 5%. Industrial and construction output had recorded faster year-on-year growth in the third quarter. The balance of trade had shown a surplus in September, albeit a rather smaller one than the forecast had expected. Data from the labour market suggested a larger-than-forecasted rise in employment in the third quarter. However, the unemployment rate was falling only moderately, in line with the forecast. The higher demand for labour was thus not generating any decrease in the number of unemployed people. Wage growth in industry and construction had remained subdued in the third quarter.

After the presentation of the situation report, the Board discussed the risks to the fulfilment of the October forecast. There was broad agreement that the risks could be viewed as balanced. Some of the board members regarded the risks of the October inflation forecast as skewed to the downside.

The slightly tighter-than-forecasted domestic monetary conditions and low growth in import prices were described as anti-inflationary factors. It was said that the exchange rate of the koruna was diverging from the assumptions of the forecast. In the opinion of some of the board members, a continuation of this trend could have a fairly strong downward effect on inflation. Several board members also mentioned oil prices, which were at rather lower levels than the October forecast had expected. On the other hand, it was said that this deviation was not all that large and that some decrease in the price of oil had been among the assumptions of the October forecast. It was also said that the strong competition in the Czech economy may prevent the high energy prices from generating inflation pressures.

In the context of the growth in the domestic energy price level, concerns were raised about the negative income effect. The consequence of this is that higher energy prices reduce households' real income and thus curb consumer demand. The argument given against this was that households are able to eliminate this downward pressure on consumption, for example by borrowing more. Aggregate consumer demand should additionally be bolstered by the higher-than-forecasted employment growth and the continuing growth in real wages. According to Labour Force Survey figures, the rising employment is being driven chiefly by manufacturing and partly also by services. Compared to previous quarters, then, the focus of employment growth may be shifting from the government sector to the more productive private sector.

The latest information concerning the impact of the increase in excise duties on cigarettes was also debated. Part of this increase will probably be absorbed by producers via a decrease in their margins. This factor would reduce the forecast for annual inflation by approximately two to three tenths of a percentage point.

The Board also discussed developments in the real economy. It was mentioned that the current relatively buoyant economic growth may also be linked with a pick-up in potential output growth. Higher potential output would of course more easily suppress the inflation effects in the economy. It was also said, however, that the rate of growth of potential output had been increased quite substantially in recent CNB forecasts and that it was difficult to find arguments for a further significant pick-up. Attention was drawn to the GDP growth volatility generated by changes in the terms of trade. The situation in some sectors of the economy was also discussed. Among other

things, it was said that the observed rise in the number of unsold new apartments may pose a risk to construction output going forward. However, this risk may be offset by continuing infrastructure investment activity. Moreover, the construction sector is itself fairly optimistic about its immediate future.

The Board's discussion also touched on the differences in interest rate and inflation expectations between the financial markets and analysts. The interest rate path derived from the yield curve, i.e. from the opinion of the market, foresees relatively significant growth in the coming quarters. By contrast, according to survey findings, financial analysts expect far more modest growth in domestic rates at the one year horizon. The analysts also expect lower inflation and higher economic growth next year by comparison with the CNB forecast.

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

MINUTES OF THE BOARD MEETING ON 22 DECEMBER 2005

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

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

Annual inflation had fallen from 2.6% in October to 2.4% in November. The forecast had been for a rise to 2.9%. Except for administered prices, which had recorded somewhat higher-than-forecasted growth, all the components of inflation had contributed to the decrease in inflation relative to the forecast. The summer increase in excise duties on cigarettes had not yet passed through to prices. Industrial producer prices and import prices had remained subdued, fluctuating below the forecasted figures. Agricultural producer prices had been in line with the forecast in November.

Third-quarter GDP growth had borne out the predictions of the October forecast in terms of both intensity and, for the most part, structure. Private consumption was recovering modestly in line with the forecast. Government consumption was rising faster than forecasted. This deviation can be put down to the one-off inclusion of military hardware imports under government consumption. The forecast of a modest pick-up in investment demand had materialised. Real exports and imports of goods and services had seen higher-than-predicted third-quarter growth. Exports had continued to outpace imports, although the positive contribution of foreign trade to GDP growth had been rather smaller than forecasted. The evolution of industrial and construction output in October and the bullish expectations of businesses and consumers suggested continuing economic growth in the coming quarters. The new data from the labour market were also consistent with the October forecast.

After the presentation of the situation report, the Board discussed the risks to the fulfilment of the October forecast. The Board agreed that there were no demand pressures on inflation apparent in the economy. The risks of the October forecast were assessed as being on the downside.

The exchange rate was identified as the biggest downside risk, having been stronger than assumed in the forecast. It was said that the extent of the appreciation could not be explained either by changes in the interest rate differential or by new fundamental factors. The current exchange rate trend may also be linked with weaker liquidity in the market due to lower trading at the year-end. Concerns were raised that the stronger exchange rate might pose a risk to the competitiveness of the Czech economy, as the nominal unit wage costs of industrial enterprises expressed in euro, unlike those expressed in koruna, are not falling.

The Board agreed that so far there was no visible pass-through of cost pressures to inflation. It was said that the economy was displaying a considerable ability to cope with the high prices of oil. During the discussion of oil prices, it was mentioned that their current koruna level and the outlook for the next few quarters are essentially in line with the assumptions of the October forecast. It was said that the faster-than-forecasted fall in fuel prices might be associated with strong competition on that market. The negative annual adjusted inflation excluding fuels and the low import price inflation and industrial producer price inflation were also mentioned in the discussion of the downside risks. The opinion was also expressed that core inflation would remain very low despite higher headline inflation.

The upside risks relative to the October forecast were generally viewed as less significant. Most attention in this respect was devoted to the higher interest rate level in the euro area, which, following the logic of uncovered interest parity, necessitates an increase in domestic interest rates. However, it was said that this upside risk to inflation was moderating the downside risks stemming from the currently stronger nominal exchange rate. Doubts were also expressed about Euribor rates staying at their present levels for much longer.

The Board discussed at length the increase in social expenditure being planned for 2007 onwards, which has been subject to approval in Parliament in recent weeks. According to preliminary analyses, these measures will have an impact on the state budget of tens of billions of koruna a year. There was broad agreement that these proposals will not contribute to the stabilisation of public finances. It was said that boosting expenditure at a time of solid

economic growth constitutes procyclical fiscal policy. Such a fiscal policy creates risks that will materialise when the current economic boom weakens. A disturbance to the fiscal consolidation process, moreover, might pose a threat to the adoption of the euro within the timescale declared by the government. Concerns were also raised about the combination of easy fiscal policy after 2007 and the increased inflow of funds from the EU budget.

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

MINUTES OF THE BOARD MEETING ON 26 JANUARY 2006

Present at the meeting:
Z. Tůma (Governor), L. Niedermayer (Vice-Governor), M. Singer (Vice-Governor), J. Frait (Chief Executive Director), R. Holman (Chief Executive Director), P. Řežábek (Chief Executive Director). Minister of Finance B. Sobotka was also present for part of the meeting.

The Board was presented with the January situation report, containing the new forecast for inflation and other macroeconomic variables.

The new forecast confirmed the low-inflation nature of the current economic recovery. By comparison with the October forecast, the prediction for inflation this year had been lowered and that for GDP growth had stayed unchanged. The decrease in expected inflation for this year had come in response to the lower-than-predicted inflation recorded at the end of last year, to the firmer exchange rate, and to a revision of the estimated impacts of the changes to excise duties. It was assumed that economic growth would continue to be driven by improving export performance, that household consumption would pick up, owing to cyclical growth in employment, and that the buoyant growth in investment demand would continue. The forecast assumed a roughly neutral effect of budget policy on economic growth this year and a slightly positive contribution next year.

The model forecast was based on partially revised estimates of the equilibrium variables that co-determine the cyclical position of the economy and the effect of the monetary conditions. Compared to the previous forecast, the estimate of the equilibrium real interest rate in the model had been lowered and the estimated rate of equilibrium real appreciation had been raised, with an assumption of a gradual decline in that rate going forward. As a result, the estimated past effect of the interest rate component of the monetary conditions had become tighter, while the previous effect of the real exchange rate was estimated to have been less tight.

Consistent with the January forecast was a gradual rise in interest rates, this being conditional, *inter alia*, on growth in interest rates abroad and broad stability of the exchange rate at roughly the level recorded at the end of last year.

After the presentation of the situation report, the Board discussed the new forecast and the risks thereto. The Board agreed that the risks were skewed to the downside. The main sources of risk were the evolution of the exchange rate and the uncertainty surrounding the rate of increase of interest rates abroad. There was a consensus, however, that foreign interest rates are by no means the sole determinant of monetary policy, since the exchange rate is affected by numerous other factors. During the discussion, concerns were raised that although the revisions to the model had improved its behaviour as regards predicting the exchange rate, it was unclear whether they would improve its ability to predict inflation. On the other hand, it was said that the revisions might have been the appropriate response to the new information on the development of the economy and that they preserved the consistency of the prediction. It was agreed that this issue would be analysed on an ongoing basis and that the Board would continue to pay attention to it.

In the discussion on the exchange rate, the Board agreed that the recent rate of appreciation was unsustainable with regard to the real economy. However, the opinion was expressed that producers had so far been able to cope with the appreciation. Against this it was argued that some worsening of exporters' situation was apparent from the latest data on corporate financial results.

It was mentioned in the debate that a halt in the appreciation of the exchange rate and a subsequent correction was one of the possible scenarios, despite the sentiment to the contrary prevailing among domestic analysts. In the discussion of the uncertainty surrounding the exchange rate going forward, attention was drawn to the potentially sizeable effect of the deficit on the income account of the balance of payments. It was also said that monetary policy should not respond hastily to short-term exchange rate swings and that the exchange rate is a highly volatile variable. On the other hand, the view was repeatedly expressed that the factors underlying the appreciation might be more permanent in nature and that the appropriate monetary response to such a shock would be to lower monetary policy interest rates.

Attention was repeatedly drawn to the low-inflation nature of the Czech economy. The very low level of core inflation was mentioned, as was the fact that the prediction of so-called monetary policy inflation, adjusted for the first-round effects of taxes, was below the inflation target at the monetary policy horizon. It was also said that average inflation had been below the target throughout the past four years, and there was a discussion of the potential impacts of the long-running undershooting of the inflation target on inflation expectations and expectations regarding the nature of monetary policy. The opinion was expressed that a temporary easing of monetary policy might be appropriate in this context in order to restore the credibility of the inflation target. On the other hand, attention was drawn to the problems generated by efforts to hit the inflation target in a situation of continuing appreciation of the exchange rate.

The Board turned its attention to the surprisingly good employment trend. There was broad agreement that the downside of this otherwise positive development was that the registered unemployed were not being employed to any greater extent. The link between the comparatively low growth in labour costs and the high and still growing proportion of non-residents in the rising employment growth was discussed.

During the debate, the members also touched on developments in the property market. The concern was raised that the likely transfer of construction work to the higher tax rate in 2008 might cause disequilibrium in this market in the interim. However, the expectations of slackening demand in the property market as suggested by survey results were also mentioned.

There was a consensus that the effect of budget policy was a source of uncertainty for monetary policy decision-making. In the context of a rapidly growing economy, there was a risk that the relatively reasonable fiscal path last year would not continue in 2006. Instead, the government might this year fully use the scope provided by the convergence programme and the approved budget in order to increase the budget deficit, and furthermore might also draw on the considerable reserves carried over from 2005.

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

Table 1a

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

CNB calculation based on CZSO data

Table 1b

INFLATION DEVELOPMENT												monthly percentage changes
2001	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**
Consumer prices	1.9	0.0	0.1	0.4	0.6	1.0	1.0	-0.2	-0.7	0.0	-0.1	0.1
Regulated prices	7.7	0.3	0.2	0.3	0.0	0.1	2.1	0.3	0.2	0.1	0.0	0.0
(contribution to consumer price inflation)	*1.43*	*0.05*	*0.05*	*0.06*	*0.00*	*0.01*	*0.41*	*0.06*	*0.04*	*0.03*	*-0.01*	*0.01*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.01*	*0.00*	*0.05*	*0.00*	*0.00*	*0.00*
Net inflation	0.6	0.0	0.0	0.4	0.8	1.3	0.7	-0.3	-1.0	-0.1	-0.1	0.2
(contribution to consumer price inflation)	*0.45*	*0.01*	*-0.01*	*0.31*	*0.57*	*1.07*	*0.56*	*-0.21*	*-0.82*	*-0.10*	*-0.05*	*0.10*
of which: prices of food, beverages and tobacco	1.2	-0.2	0.1	0.7	0.8	2.0	-0.9	-1.0	-0.8	0.0	0.0	0.9
(contribution to consumer price inflation)	*0.33*	*-0.06*	*0.03*	*0.19*	*0.23*	*0.56*	*-0.24*	*-0.27*	*-0.21*	*0.00*	*-0.01*	*0.24*
adjusted inflation	0.2	0.1	-0.1	0.2	0.7	1.0	1.5	0.1	-1.2	-0.2	-0.1	-0.3
(contribution to consumer price inflation)	*0.12*	*0.07*	*-0.04*	*0.12*	*0.34*	*0.51*	*0.81*	*0.06*	*-0.62*	*-0.10*	*-0.03*	*-0.14*
2002												
Consumer prices	1.5	0.2	-0.1	-0.1	-0.1	-0.3	0.5	-0.2	-0.5	-0.3	-0.2	0.2
Regulated prices	3.7	0.8	0.2	-1.1	-0.1	0.0	1.1	0.0	0.1	-1.3	0.0	-0.1
(contribution to consumer price inflation)	*0.75*	*0.16*	*0.04*	*-0.23*	*-0.03*	*0.00*	*0.23*	*-0.01*	*0.03*	*-0.26*	*0.00*	*-0.02*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*
Net inflation	0.9	0.0	-0.2	0.2	-0.1	-0.3	0.3	-0.2	-0.7	0.0	-0.1	0.2
(contribution to consumer price inflation)	*0.74*	*-0.03*	*-0.14*	*0.20*	*-0.11*	*-0.24*	*0.20*	*-0.19*	*-0.58*	*0.01*	*-0.11*	*0.13*
of which: prices of food, beverages and tobacco	1.5	-0.4	-0.5	0.1	-0.3	-1.2	-1.9	-1.0	-0.1	0.0	-0.3	0.7
(contribution to consumer price inflation)	*0.41*	*-0.11*	*-0.14*	*0.01*	*-0.08*	*-0.32*	*-0.50*	*-0.25*	*-0.03*	*-0.01*	*-0.08*	*0.18*
adjusted inflation	0.6	0.2	0.0	0.3	-0.1	0.2	1.3	0.1	-1.0	0.0	-0.1	-0.1
(contribution to consumer price inflation)	*0.33*	*0.08*	*0.00*	*0.18*	*-0.04*	*0.08*	*0.70*	*0.07*	*-0.56*	*0.02*	*-0.03*	*-0.05*
2003												
Consumer prices	0.6	0.2	-0.1	0.2	0.0	0.0	0.1	-0.2	-0.5	0.1	0.5	0.2
Regulated prices	0.1	0.3	0.2	1.1	-0.1	0.0	0.0	0.0	0.1	-0.4	0.0	0.0
(contribution to consumer price inflation)	*0.03*	*0.06*	*0.03*	*0.23*	*-0.01*	*0.01*	*0.00*	*0.00*	*0.01*	*-0.09*	*0.00*	*0.00*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*
Net inflation	0.7	0.2	-0.2	0.0	0.0	0.1	0.0	-0.1	-0.6	0.3	0.5	0.3
(contribution to consumer price inflation)	*0.55*	*0.14*	*-0.13*	*-0.03*	*-0.04*	*0.05*	*0.03*	*-0.11*	*-0.49*	*0.22*	*0.39*	*0.20*
of which: prices of food, beverages and tobacco	0.8	-0.2	-0.2	0.1	0.4	0.6	-1.7	-1.0	0.6	0.7	1.6	0.8
(contribution to consumer price inflation)	*0.22*	*-0.05*	*-0.05*	*0.04*	*0.10*	*0.16*	*-0.44*	*-0.25*	*0.16*	*0.18*	*0.42*	*0.22*
adjusted inflation	0.6	0.3	-0.1	-0.1	-0.3	-0.2	0.9	0.3	-1.2	0.1	-0.1	0.0
(contribution to consumer price inflation)	*0.33*	*0.18*	*-0.07*	*-0.06*	*-0.14*	*-0.11*	*0.47*	*0.15*	*-0.65*	*0.03*	*-0.03*	*-0.02*
2004												
Consumer prices	1.8	0.2	0.1	0.0	0.4	0.2	0.4	0.0	-0.8	0.5	-0.1	0.1
Regulated prices	3.7	0.2	0.0	-0.5	-0.7	0.0	0.0	-0.1	0.0	1.6	0.0	0.0
(contribution to consumer price inflation)	*0.76*	*0.04*	*0.01*	*-0.10*	*-0.15*	*0.00*	*0.00*	*-0.03*	*0.01*	*0.34*	*-0.01*	*0.00*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.35*	*0.00*	*0.00*	*0.04*	*0.23*	*0.07*	*0.04*	*0.01*	*0.03*	*0.00*	*0.00*	*0.00*
Net inflation	0.9	0.1	0.1	0.0	0.5	0.1	0.4	0.0	-1.0	0.2	0.0	0.2
(contribution to consumer price inflation)	*0.74*	*0.09*	*0.10*	*0.03*	*0.37*	*0.12*	*0.33*	*-0.01*	*-0.78*	*0.12*	*-0.04*	*0.12*
of which: prices of food, beverages and tobacco	1.0	-0.2	0.1	0.3	0.5	-0.1	-0.6	-0.6	-0.6	0.0	0.0	1.1
(contribution to consumer price inflation)	*0.26*	*-0.05*	*0.02*	*0.07*	*0.14*	*-0.03*	*-0.15*	*-0.15*	*-0.16*	*-0.01*	*0.01*	*0.28*
adjusted inflation	0.9	0.3	0.1	-0.1	0.4	0.3	0.9	0.3	-1.2	0.2	-0.1	-0.3
(contribution to consumer price inflation)	*0.48*	*0.14*	*0.08*	*-0.04*	*0.23*	*0.14*	*0.48*	*0.14*	*-0.63*	*0.13*	*-0.05*	*-0.16*
2005												
Consumer prices	0.7	0.2	-0.1	0.1	0.2	0.6	0.3	0.0	-0.3	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*

CNB calculation based on CZSO data

Table 2

CONSUMER PRICES percentage changes; December 1999 = 100

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

Source: CZSO

Table 3

CONSUMER PRICES - TRADABLES AND NONTRADABLES

percentage changes; December 1999 = 100

Group	Constant 1999 weights in per mille	2001 12	2002 12	2003 12	2004 12	2005 3	2005 6	2005 9	2005 12
1. Food and non-alcoholic beverages	197.6	7.9	2.1	5.7	6.6	6.8	7.5	4.4	5.6
- tradables	197.6	7.9	2.1	5.7	6.6	6.8	7.5	4.4	5.6
2. Alcoholic beverages and tobacco	79.2	5.4	7.1	7.8	11.6	12.7	12.5	12.3	12.4
- tradables	79.2	5.4	7.1	7.8	11.6	12.7	12.5	12.3	12.4
3. Clothing and footwear	56.9	-3.9	-7.7	-11.9	-14.6	-18.4	-18.3	-20.6	-20.2
- nontradables	1.4	13.0	18.3	21.1	35.9	36.9	37.1	37.6	38.4
- tradables	55.5	-4.3	-8.4	-12.7	-15.9	-19.8	-19.7	-22.1	-21.7
4. Housing, water, electricity, gas and other fuels	236.4	19.0	24.3	26.6	32.2	35.1	35.0	35.8	38.9
- nontradables	226.1	19.7	25.2	27.5	33.2	36.2	36.1	36.9	40.1
- tradables	10.3	2.7	4.0	5.9	10.7	11.9	10.6	12.0	12.4
5. Furnishings, household equipment and routine maintenance of the house	67.9	-0.4	-1.0	-3.0	-4.9	-5.5	-5.9	-6.4	-6.6
- nontradables	2.9	7.5	9.9	12.3	16.8	15.7	16.5	17.1	17.3
- tradables	65.0	-0.8	-1.5	-3.7	-5.9	-6.5	-6.9	-7.5	-7.7
6. Health	14.3	8.4	12.8	16.4	20.6	26.7	30.1	31.0	29.5
- nontradables	11.0	10.1	15.4	19.9	25.2	33.2	37.4	38.5	36.5
- tradables	3.3	2.7	4.4	5.1	5.6	5.7	6.4	6.4	6.7
7. Transport	101.4	3.4	4.1	3.6	5.0	4.1	7.8	13.6	8.8
- nontradables	27.4	11.7	16.0	18.4	23.0	24.4	24.7	26.3	26.8
- tradables	74.0	0.3	-0.3	-1.9	-1.6	-3.4	1.5	8.9	2.1
8. Communications	22.5	5.7	8.2	7.2	21.0	20.1	38.6	38.2	38.1
- nontradables	21.0	8.5	2.1	2.3	16.6	15.8	46.8	46.5	46.5
- tradables	1.5	-34.7	95.9	77.5	83.6	82.0	-79.0	-80.8	-82.3
9. Recreation and culture	95.5	7.2	7.2	6.1	7.9	10.1	10.1	10.1	10.5
- nontradables	60.4	14.3	16.2	16.7	21.2	25.0	26.2	26.8	27.4
- tradables	35.1	-5.0	-8.3	-12.1	-15.0	-15.5	-17.7	-18.7	-18.6
10. Education	4.5	6.8	11.3	12.0	18.1	15.8	15.6	19.5	20.2
- nontradables	4.5	6.8	11.3	12.0	18.1	15.8	15.6	19.5	20.2
11. Hotels, cafés and restaurants	74.2	5.9	8.7	10.8	19.6	21.2	21.5	22.4	22.8
- nontradables	74.2	5.9	8.7	10.8	19.6	21.2	21.5	22.4	22.8
12. Miscellaneous goods and services	49.5	8.7	11.9	15.2	20.3	20.9	20.7	20.7	20.9
- nontradables	22.0	17.5	25.8	36.4	48.4	50.3	50.7	51.2	51.5
- tradables	27.5	1.7	0.8	-1.7	-2.2	-2.6	-3.2	-3.6	-3.5
Household consumer prices, total	1,000.0	8.4	9.0	10.1	13.2	14.1	15.0	15.1	15.7
Tradables	549.1	2.9	0.6	0.7	0.9	0.4	0.6	0.1	-0.3
- food	276.8	7.2	3.5	6.3	8.0	8.5	8.9	6.7	7.5
- others	272.3	-1.5	-2.4	-5.0	-6.3	-7.8	-7.8	-6.5	-8.3
Nontradables	450.9	15.2	19.2	21.6	28.2	30.8	32.6	33.4	35.2
- others	271.2	11.5	16.5	19.4	26.9	28.9	29.5	33.1	32.8
- regulated	179.7	20.6	23.2	24.9	30.3	33.7	37.3	33.8	38.8

CNB calculation based on CZSO data

Table 4

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

		CPI	
	Financial market	Businesses	Households
1/01	4.5	—	—
2/01	4.3	—	—
3/01	4.2	4.2	4.0
4/01	4.0	—	—
5/01	4.3	—	—
6/01	4.6	4.8	5.1
7/01	4.6	—	—
8/01	4.7	—	—
9/01	4.8	4.7	4.9
10/01	4.4	—	—
11/01	4.0	—	—
12/01	3.9	3.9	4.6
1/02	3.8	—	—
2/02	3.5	—	—
3/02	3.5	3.6	3.9
4/02	3.5	—	—
5/02	3.3	—	—
6/02	3.1	2.7	1.6
7/02	2.8	—	—
8/02	2.7	—	—
9/02	3.1	2.4	1.3
10/02	2.5	—	—
11/02	2.4	—	—
12/02	2.3	2.3	2.3
1/03	2.5	—	—
2/03	2.4	—	—
3/03	2.5	2.1	4.3
4/03	2.6	—	—
5/03	3.7	—	—
6/03	3.2	2.6	1.7
7/03	3.3	—	—
8/03	3.2	—	—
9/03	3.1	2.6	3.1
10/03	3.0	—	—
11/03	3.1	—	—
12/03	3.3	2.9	4.2
1/04	2.9	—	—
2/04	3.2	—	—
3/04	3.0	3.3	4.9
4/04	2.8	—	—
5/04	2.6	—	—
6/04	2.7	3.1	4.9
7/04	2.8	—	—
8/04	2.8	—	—
9/04	3.0	3.1	1.7
10/04	2.8	—	—
11/04	2.8	—	—
12/04	2.8	3.2	1.5
1/05	2.8	—	—
2/05	2.6	—	—
3/05	2.6	2.7	3.8
4/05	2.5	—	—
5/05	2.4	—	—
6/05	2.3	2.7	3.8
7/05	2.4	—	—
8/05	2.5	—	—
9/05	2.5	2.8	5.2
10/05	2.7		
11/05	2.8		
12/05	2.6	2.8	4.6

Source: CNB statistical survey

Table 5

HARMONISED INDEX OF CONSUMER PRICES

annual percentage changes

	2001 12	2002 12	2003 12	2004 12	2005 12
Belgium	2.0	1.3	1.7	1.9	2.8
Denmark	2.1	2.6	1.2	1.0	2.2
Finland	2.3	1.7	1.2	0.1	1.1
France	1.4	2.2	2.4	2.3	1.8
Ireland	4.4	4.6	2.9	2.4	1.9
Italy	2.2	3.0	2.5	2.4	2.1
Luxembourg	0.9	2.8	2.4	3.5	3.4
Germany	1.4	1.1	1.1	2.2	2.1
Netherlands	5.1	3.2	1.6	1.2	2.1
Portugal	3.9	4.0	2.3	2.6	2.5
Austria	1.8	1.7	1.3	2.5	1.6
Greece	3.5	3.5	3.1	3.1	3.5
Spain	2.5	4.0	2.7	3.3	3.7
Sweden	3.2	1.7	1.8	0.9	1.3
United Kingdom	1.0	1.7	1.3	1.6	2.0
European Union	1.9	2.2	1.8	2.2	2.2
Czech Republic	3.9	0.1	1.0	2.5	1.9

Source: Eurostat

Table 6

MONETARY SURVEY					position at month-end in CZK billions
	2001 12	2002 12	2003 12	2004 12	2005 11
Total assets	1,596.0	1,651.8	1,766.1	1,844.1	1,965.4
Net external assets (NEAs)	800.6	926.1	821.5	863.3	1,066.5
NEAs of CNB	__	715.6	687.5	634.1	718.1
NEAs of OMFIs	__	210.5	134.0	229.3	348.3
Net domestic assets	795.4	725.8	944.5	980.8	898.9
Domestic loans	1,011.9	940.0	1,145.6	1,147.0	1,147.7
Net credit to government (NCG) (including securities)	__	215.8	354.0	257.5	91.7
NCG to central government (including securities)	__	260.4	408.7	312.4	169.5
NCG to other government (including securities)	__	-44.6	-54.8	-54.9	-77.8
Loans to corporations and households (excluding securities)	775.4	724.2	791.6	889.4	1,056.0
Loans to corporations (excluding securities)	636.1	542.7	554.1	574.2	654.0
Loans to households (excluding securities)	139.3	181.5	237.5	315.2	402.0
Other net items (including securities and capital)	-216.5	-214.3	-201.1	-166.2	-248.8
Holdings of securities	__	18.5	16.6	18.8	14.7
Issued securities	__	-48.6	-51.6	-74.9	-112.8
Liabilities					
Monetary aggregate M2	1,596.0	1,651.8	1,766.1	1,844.1	1,965.4
Monetary aggregate M1	583.6	787.7	902.8	962.3	1,078.1
Currency in circulation	180.4	197.8	221.4	236.8	262.7
Overnight deposits	__	589.9	681.4	725.6	815.4
Overnight deposits - households	__	315.6	372.1	410.8	463.4
Overnight deposits - corporations	__	274.3	309.3	314.7	352.0
M2-M1 (quasi money)	1,012.4	864.1	863.3	881.8	887.3
Deposits with agreed maturity	__	651.2	666.4	675.3	670.3
Deposits with agreed maturity - households	__	448.6	439.8	458.6	438.6
Deposits with agreed maturity - corporations	__	202.5	226.6	216.7	231.7
Deposits redeemable at notice	__	194.3	185.6	198.8	207.3
Deposits redeemable at notice - households	__	190.7	182.3	194.6	203.8
Deposits redeemable at notice - corporations	__	3.6	3.2	4.2	3.5
Repurchase agreements	__	18.6	11.3	7.6	9.7
Annual percentage changes					
M1	17.3	35.0	14.6	6.6	10.5
M2	13.0	3.5	6.9	4.4	6.8
Loans to corporations and households	-19.6	-6.6	9.3	12.4	18.7
M2-M1 (deposits)	10.7	-14.6	-0.1	2.1	2.6
Annual percentage growth rates					
M1	__	__	15.5	8.3	10.9
M2	__	__	8.1	5.8	7.1
Loans to corporations and households	__	__	11.8	15.3	19.9
M2-M1 (deposits)	__	__	1.2	3.3	2.9

Table 7

INTEREST RATES ON INTERBANK DEPOSITS

percentages

	2001 12	2002 12	2003 12	2004 12	2005 12
1. Average PRIBOR [1]					
- 1 day	4.63	2.75	1.98	2.49	2.00
- 7 day	4.79	2.76	2.02	2.51	2.04
- 14 day	4.78	2.76	2.03	2.51	2.04
- 1 month	4.77	2.73	2.04	2.53	2.05
- 2 month	4.72	2.67	2.06	2.55	2.10
- 3 month	4.69	2.63	2.08	2.57	2.17
- 6 month	4.62	2.60	2.13	2.67	2.33
- 9 month	4.61	2.60	2.22	2.76	2.44
- 12 month	4.62	2.60	2.30	2.85	2.53
2. Average PRIBID [1]					
- 1 day	4.53	2.65	1.88	2.39	1.90
- 7 day	4.69	2.67	1.92	2.41	1.94
- 14 day	4.69	2.67	1.93	2.41	1.94
- 1 month	4.68	2.64	1.94	2.43	1.95
- 2 month	4.62	2.57	1.96	2.45	2.00
- 3 month	4.59	2.54	1.98	2.47	2.07
- 6 month	4.52	2.51	2.03	2.57	2.23
- 9 month	4.52	2.51	2.12	2.66	2.34
- 12 month	4.52	2.51	2.20	2.75	2.43

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

Table 8

FRA RATES					percentages; monthly averages
	2001	2002	2003	2004	2005
	12	12	12	12	12
3 * 6	4.49	2.52	2.23	2.74	2.46
3 * 9	4.53	2.54	2.36	2.81	2.57
6 * 9	4.53	2.52	2.47	2.85	2.66
6 * 12	4.52	2.58	2.64	2.92	2.74
9 * 12	4.54	2.61	2.77	2.97	2.79
9*12 - 3*6 spread	0.05	0.10	0.55	0.24	0.33
6*12 - 3*9 spread	-0.02	0.04	0.28	0.12	0.17

IRS RATES					percentages; monthly averages
	2001	2002	2003	2004	2005
	12	12	12	12	12
1Y	4.64	2.63	2.41	2.82	2.56
2Y	4.72	2.85	2.98	3.06	2.82
3Y	4.89	3.18	3.38	3.27	3.00
4Y	5.05	3.46	3.69	3.45	3.13
5Y	5.19	3.70	3.93	3.62	3.25
6Y	5.32	3.91	4.13	3.77	3.33
7Y	5.43	4.08	4.29	3.89	3.40
8Y	5.52	4.23	4.43	4.00	3.46
9Y	5.60	4.36	4.54	4.09	3.52
10Y	5.66	4.47	4.64	4.17	3.58
15Y	5.85	4.77	4.97	4.40	3.78
20Y	—	—	5.11	4.54	3.88
5Y - 1Y spread	0.56	1.07	1.52	0.80	0.69
10Y - 1Y spread	1.02	1.84	2.23	1.35	1.02

Table 9

NOMINAL AND REAL INTEREST RATES (ex post approach)

percentages

	Nominal rates				Real rates based on CPI				Real rates based on PPI		
	PRIBOR		client rates		PRIBOR		client rates		PRIBOR		new
	2W	1Y	new loans	time deposits	2W	1Y	new loans	time deposits	2W	1Y	client loans
1/01	5.3	5.6	6.3	3.9	1.0	1.3	2.0	-0.3	1.0	1.3	2.0
2/01	5.2	5.3	6.2	3.9	1.2	1.3	2.1	-0.1	0.5	0.6	1.4
3/01	5.0	5.1	6.2	3.7	0.9	0.9	2.0	-0.3	0.9	0.9	2.0
4/01	5.0	5.0	6.2	3.7	0.4	0.4	1.5	-0.9	1.0	0.9	2.1
5/01	5.0	5.0	6.3	3.7	0.0	0.0	1.2	-1.2	1.2	1.2	2.4
6/01	5.0	5.3	6.3	3.7	-0.4	-0.2	0.7	-1.7	1.6	1.8	2.8
7/01	5.1	5.6	6.4	3.7	-0.8	-0.2	0.5	-2.1	2.0	2.6	3.3
8/01	5.3	6.0	6.6	3.7	-0.2	0.5	1.0	-1.7	2.8	3.5	4.1
9/01	5.3	5.7	6.6	3.7	0.6	0.9	1.8	-0.9	3.4	3.8	4.7
10/01	5.3	5.3	6.6	3.7	0.9	0.9	2.1	-0.7	3.9	4.0	5.3
11/01	5.2	4.9	6.3	3.6	1.0	0.7	2.0	-0.5	4.3	4.0	5.4
12/01	4.8	4.6	5.9	3.3	0.7	0.5	1.7	-0.8	4.0	3.8	5.1
1/02	4.7	4.5	5.7	3.2	1.0	0.8	2.0	-0.4	4.1	3.9	5.1
2/02	4.3	4.4	5.1	3.0	0.4	0.5	1.1	-0.8	4.4	4.5	5.2
3/02	4.3	4.5	5.3	3.0	0.6	0.8	1.6	-0.7	4.5	4.7	5.5
4/02	4.2	4.4	5.1	2.9	1.0	1.1	1.8	-0.2	4.3	4.5	5.2
5/02	3.8	4.1	4.9	2.8	1.3	1.5	2.3	0.3	4.3	4.6	5.4
6/02	3.8	3.9	5.0	2.9	2.6	2.7	3.8	1.7	4.6	4.8	5.9
7/02	3.5	3.4	4.5	2.8	2.9	2.8	3.9	2.2	4.7	4.6	5.7
8/02	3.0	3.1	4.4	2.3	2.4	2.5	3.8	1.7	4.0	4.1	5.4
9/02	3.0	3.0	4.5	2.5	2.2	2.1	3.7	1.7	4.0	3.9	5.5
10/02	3.0	2.8	4.6	2.3	2.4	2.2	4.0	1.7	3.9	3.7	5.5
11/02	2.8	2.8	4.2	2.1	2.3	2.2	3.7	1.6	3.5	3.5	4.9
12/02	2.8	2.6	4.2	2.2	2.1	2.0	3.6	1.6	3.5	3.3	4.9
1/03	2.7	2.6	4.1	2.2	3.2	3.0	4.5	2.6	3.6	3.5	5.0
2/03	2.5	2.4	3.9	2.1	2.9	2.8	4.3	2.5	3.2	3.2	4.6
3/03	2.5	2.4	3.9	2.0	2.9	2.8	4.3	2.5	2.9	2.8	4.3
4/03	2.5	2.4	3.9	2.0	2.6	2.5	4.0	2.1	3.2	3.2	4.7
5/03	2.5	2.4	4.0	2.0	2.5	2.4	4.0	2.0	3.3	3.3	4.8
6/03	2.5	2.3	3.8	1.9	2.2	2.0	3.5	1.6	3.4	3.2	4.8
7/03	2.3	2.2	3.5	1.7	2.4	2.3	3.6	1.8	2.9	2.9	4.2
8/03	2.0	2.1	3.3	1.8	2.1	2.2	3.4	1.9	2.4	2.5	3.7
9/03	2.0	2.2	3.6	1.7	2.0	2.2	3.6	1.7	2.0	2.2	3.6
10/03	2.0	2.2	3.7	1.7	1.6	1.8	3.3	1.3	2.1	2.3	3.8
11/03	2.0	2.2	3.5	1.8	1.0	1.2	2.5	0.7	1.6	1.8	3.1
12/03	2.0	2.3	3.7	1.7	1.0	1.3	2.6	0.7	1.1	1.4	2.7
1/04	2.0	2.3	5.5	1.4	-0.3	0.0	3.1	-0.9	0.4	0.7	3.9
2/04	2.0	2.3	5.0	1.4	-0.3	0.0	2.7	-0.9	0.5	0.8	3.5
3/04	2.0	2.3	5.1	1.5	-0.5	-0.2	2.6	-1.0	-0.1	0.2	3.0
4/04	2.0	2.3	5.4	1.5	-0.3	0.0	3.0	-0.8	-1.6	-1.4	1.6
5/04	2.0	2.5	5.4	1.5	-0.7	-0.2	2.6	-1.2	-2.7	-2.3	0.5
6/04	2.1	2.8	5.3	1.6	-0.8	-0.1	2.4	-1.3	-3.9	-3.2	-0.8
7/04	2.3	3.0	5.7	1.7	-0.9	-0.2	2.4	-1.5	-4.7	-4.0	-1.5
8/04	2.3	3.0	6.0	1.7	-1.0	-0.4	2.5	-1.7	-5.3	-4.7	-1.9
9/04	2.5	3.1	5.9	1.8	-0.5	0.1	2.9	-1.2	-5.1	-4.5	-1.9
10/04	2.5	3.0	6.0	1.8	-1.0	-0.4	2.4	-1.6	-5.6	-5.1	-2.4
11/04	2.5	2.9	6.1	1.8	-0.4	0.0	3.1	-1.1	-5.3	-4.9	-2.0
12/04	2.5	2.8	6.1	1.9	-0.3	0.0	3.2	-0.9	-4.8	-4.5	-1.5
1/05	2.5	2.7	6.2	1.8	0.8	1.0	4.4	0.1	-4.4	-4.2	-1.0
2/05	2.3	2.2	6.0	1.7	0.6	0.5	4.2	0.0	-4.5	-4.5	-1.1
3/05	2.2	2.1	5.6	1.7	0.7	0.6	4.1	0.2	-3.9	-4.0	-0.7
4/05	2.0	2.1	5.9	1.6	0.4	0.4	4.2	0.0	-3.4	-3.4	0.2
5/05	1.8	1.8	5.7	1.4	0.5	0.5	4.3	0.1	-2.1	-2.1	1.6
6/05	1.8	1.8	5.3	1.4	0.0	0.0	3.4	-0.4	-0.9	-0.9	2.5
7/05	1.8	1.8	5.3	1.4	0.1	0.1	3.6	-0.3	-0.2	-0.2	3.3
8/05	1.8	1.9	5.3	1.4	0.1	0.2	3.5	-0.3	0.7	0.8	4.1
9/05	1.8	1.9	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	—	—	-0.2	0.3	—	—	2.3	2.8	—

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

Table 10

REAL INTEREST RATES (ex ante approach)

percentages

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

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

Table 11

KORUNA INTEREST RATES (stock of business)

percentages

	2001 12	2002 12	2003 12	2004 12	2005 11
Koruna interest rates on loans provided by banks to residents:					
Households and non-profit institutions serving households (S.14+S.15) - total	8.74	8.77	8.24	7.96	7.21
- maturity up to 1 year	8.20	10.35	11.21	12.82	12.94
- maturity over 1 year and up to 5 years	10.55	10.80	10.17	12.40	11.45
- maturity over 5 years	8.02	7.35	6.65	6.39	5.98
for consumption - total	__	13.83	13.83	14.89	13.94
- maturity up to 1 year	__	13.05	14.26	15.48	16.31
- maturity over 1 year and up to 5 years	__	14.48	13.86	15.17	15.01
- maturity over 5 years	__	12.55	13.21	13.45	11.84
for house purchase - total	__	7.11	6.31	5.93	5.29
- maturity up to 1 year	__	7.67	6.24	4.48	4.23
- maturity over 1 year and up to 5 years	__	7.90	7.05	6.57	6.24
- maturity over 5 years	__	6.88	6.09	5.89	5.25
other - total	__	6.99	7.80	7.50	7.04
- maturity up to 1 year	__	6.64	8.49	8.96	8.91
- maturity over 1 year and up to 5 years	__	6.34	8.02	7.63	7.15
- maturity over 5 years	__	7.61	7.02	6.58	5.86
Non-financial corporations (S.11) - total	6.84	5.19	4.53	4.75	4.16
- maturity up to 1 year	6.32	4.34	4.08	4.35	3.83
- maturity over 1 year and up to 5 years	6.93	5.47	4.64	4.68	4.07
- maturity over 5 years	7.52	6.34	5.14	5.39	4.71
Koruna interest rates on deposits accepted by banks from residents:					
Households and non-profit institutions serving households (S.14+S.15) - total	2.63	1.72	1.30	1.41	1.21
overnight	1.42	0.94	0.50	0.52	0.40
with agreed maturity - total	3.11	2.26	2.02	2.13	1.91
- with agreed maturity up to 2 years	__	1.68	0.96	1.37	0.95
- with agreed maturity over 2 years	__	3.04	2.90	2.69	2.53
redeemable at notice - total	__	1.81	1.26	1.63	1.62
- redeemable at notice up to 3 months	__	1.93	1.67	2.14	2.21
- redeemable at notice over 3 months	__	1.73	0.98	1.12	0.81
Non-financial corporations (S.11) - total	1.96	1.25	0.85	1.21	1.02
overnight	1.00	0.94	0.64	0.68	0.61
with agreed maturity - total	3.62	2.16	1.50	2.08	1.65
- with agreed maturity up to 2 years	__	2.15	1.49	2.05	1.62
- with agreed maturity over 2 years	__	3.47	3.04	3.12	2.47
redeemable at notice - total	__	1.64	1.17	1.60	1.16
- redeemable at notice up to 3 months	__	1.60	1.14	1.49	1.14
- redeemable at notice over 3 months	__	2.26	1.32	2.26	1.42

Table 12

BALANCE OF PAYMENTS [1]					in CZK millions
	2001	2002	2003	2004 [2]	2005 [2]
	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q3
A. Current account	-124,478.3	-136,378.1	-160,614.6	-143,259.0	-32,509.3
Balance of trade [3]	-116,685.0	-71,323.0	-69,793.0	-22,325.0	257.0
exports	1,269,634.0	1,254,394.0	1,370,930.0	1,713,694.0	459,856.0
imports	1,386,319.0	1,325,717.0	1,440,723.0	1,736,019.0	459,599.0
Services	57,984.9	21,850.8	13,236.7	12,472.5	3,885.7
credit	269,689.6	231,131.1	219,151.1	248,433.1	67,416.6
transport	57,492.3	56,560.5	60,556.3	72,308.9	20,735.4
travel	118,133.0	96,289.2	100,310.1	107,129.8	30,324.1
others	94,064.3	78,281.4	58,284.7	68,994.4	16,357.1
debit	211,704.7	209,280.3	205,914.4	235,960.6	63,530.9
transport	30,570.5	29,332.8	33,725.7	38,603.0	11,775.3
travel	52,802.0	51,549.3	54,419.2	58,362.8	17,902.9
others	128,332.2	128,398.2	117,769.5	138,994.8	33,852.7
Income	-83,548.9	-115,615.0	-119,858.4	-139,535.9	-37,098.9
credit	84,892.3	66,790.1	75,508.3	70,209.1	25,663.2
debit	168,441.2	182,405.1	195,366.7	209,745.0	62,762.1
Current transfers	17,770.7	28,709.1	15,800.1	6,129.4	446.9
credit	36,404.9	46,709.0	46,976.7	46,045.3	12,470.7
debit	18,634.2	17,999.9	31,176.6	39,915.9	12,023.8
B. Capital account	-330.7	-119.4	-82.2	-14,017.0	43.9
credit	90.4	221.0	198.2	5,608.2	396.2
debit	421.1	340.4	280.4	19,625.2	352.3
Total A + B	*-124,809.0*	*-136,497.5*	*-160,696.8*	*-157,276.0*	*-32,465.4*
C. Financial account	172,849.9	347,827.4	157,093.5	180,923.0	32,375.3
Direct investment	208,296.1	270,930.2	53,500.3	100,673.6	43,442.2
abroad	-6,289.2	-6,759.3	-5,815.7	-14,038.9	-10,523.5
equity capital and reinvested earnings	-5,848.5	-5,376.8	-3,124.6	-12,732.3	-843.1
other capital	-440.7	-1,382.5	-2,691.1	-1,306.6	-9,680.4
in the Czech Republic	214,585.3	277,689.5	59,316.0	114,712.5	53,965.7
equity capital and reinvested earnings	185,981.4	270,061.0	59,350.4	104,432.3	53,718.8
other capital	28,603.9	7,628.5	-34.4	10,280.2	246.9
Portfolio investment	34,857.3	-46,748.7	-35,719.1	62,209.2	-32,991.5
assets	4,405.6	-75,602.1	-83,892.7	-61,068.5	-14,930.0
equity securities	9,447.8	-7,807.9	5,630.5	-27,280.4	-9,358.6
debt securities	-5,042.2	-67,794.2	-89,523.2	-33,788.1	-5,571.4
liabilities	30,451.7	28,853.4	48,173.6	123,277.7	-18,061.5
equity securities	23,203.6	-9,035.7	30,133.5	19,558.6	-16,069.7
debt securities	7,248.1	37,889.1	18,040.1	103,719.1	-1,991.8
Financial derivatives	-3,220.3	-4,281.7	3,860.1	-1,539.7	-2,841.8
assets	-9,407.6	-15,458.4	7,083.7	-13,902.7	2,790.0
liabilities	6,187.3	11,176.7	-3,223.6	12,363.0	-5,631.8
Other investment	-67,083.2	127,927.6	135,452.2	19,579.9	24,766.4
assets	-46,144.5	133,121.8	67,071.3	-35,983.8	-23,332.8
long-term	1,325.8	28,711.4	1,141.3	20,516.9	-8,001.7
CNB	—	—	—	-184.9	0.0
commercial banks	-4,125.8	5,271.7	-999.9	587.7	-10,147.9
government	6,928.9	25,333.6	5,714.3	22,790.7	4,100.6
other sectors	-1,477.3	-1,893.9	-3,573.1	-2,676.6	-1,954.4
short-term	-47,470.3	104,410.4	65,930.0	-56,500.7	-15,331.1
commercial banks	-45,523.2	122,163.8	44,971.2	-34,807.6	-10,774.4
government	-87.1	-2,237.4	2,193.8	92.9	0.3
other sectors	-1,860.0	-15,516.0	18,765.0	-21,786.0	-4,557.0
liabilities	-20,938.7	-5,194.2	68,380.9	55,563.7	48,099.2
long-term	-4,262.6	2,853.8	26,361.6	29,813.4	19,496.6
CNB	-22.0	-20.2	-20.4	-20.5	-9.4
commercial banks	-7,222.2	-8,059.2	-5,038.0	-1,410.8	2,008.1
government	-5,000.8	-1,517.2	10,304.7	9,264.7	8,271.0
other sectors	7,982.4	12,450.4	21,115.3	21,980.0	9,226.9
short-term	-16,676.1	-8,048.0	42,019.3	25,750.3	28,602.6
CNB	59.7	-24.3	-21.4	843.7	1,680.7
commercial banks	-35,688.6	-3,871.2	37,899.4	-14,766.2	20,990.7
government	—	—	—	—	—
other sectors	18,952.8	-4,152.5	4,141.3	39,672.8	5,931.2
Total A + B + C	*48,040.9*	*211,329.9*	*-3,603.3*	*23,647.0*	*-90.1*
D. Net errors and omissions, valuation changes	19,112.1	5,615.1	16,506.7	-16,864.8	2,771.2
Total A + B + C + D	*67,153.0*	*216,945.0*	*12,903.4*	*6,782.2*	*2,681.1*
E. Change in reserves (- increase)	-67,153.0	-216,945.0	-12,903.4	-6,782.2	-2,681.1

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

Table 13

INTERNATIONAL INVESTMENT POSITION

in CZK millions

	2001 31 Dec.	2002 31 Dec.	2003 31 Dec.	2004[1)] 31 Dec.	2005[1)] 30 Sep.
Assets	1,544,963.0	1,579,922.9	1,537,284.6	1,535,040.8	1,784,902.0
Direct investment abroad	41,176.1	44,397.1	58,581.5	68,450.0	81,450.0
- equity capital	37,633.6	39,472.1	50,965.5	60,050.0	63,500.0
- other capital	3,542.5	4,925.0	7,616.0	8,400.0	17,950.0
Portfolio investment	185,138.6	274,344.7	343,968.7	369,425.6	419,332.8
- equity securities	68,675.5	86,464.7	47,337.7	73,309.3	97,769.6
- debt securities	116,463.1	187,880.0	296,631.0	296,116.3	321,563.2
Financial derivatives	15,754.8	31,213.2	24,129.5	38,032.2	47,919.4
Other investment	778,435.7	515,356.2	419,090.0	422,891.5	502,312.4
long-term	310,133.9	179,639.6	157,598.6	118,694.3	126,419.4
- CNB	307.3	280.9	468.4	600.0	777.9
- commercial banks	79,663.7	67,966.9	66,121.3	58,055.5	68,096.2
- government	210,694.9	97,156.8	79,483.9	48,918.8	42,725.3
- other sectors	19,468.0	14,235.0	11,525.0	11,120.0	14,820.0
short-term	468,301.8	335,716.6	261,491.4	304,197.2	375,893.0
- CNB	51.2	376.7	98.8	71.7	77.5
- commercial banks	359,638.5	213,815.4	161,150.2	185,146.0	249,564.0
of which: gold and foreign exchange	257,138.6	163,032.9	115,884.8	128,118.7	161,273.0
- government	87.1	2,324.5	102.4	9.5	1.5
- other sectors	108,525.0	119,200.0	100,140.0	118,970.0	126,250.0
CNB reserves	524,457.8	714,611.7	691,514.9	636,241.5	733,887.4
- gold	4,469.9	4,653.8	4,784.3	4,253.9	5,051.5
- SDR	31.0	137.1	238.7	118.0	252.8
- reserve position in the IMF	5,478.3	7,081.5	11,949.9	9,137.5	6,738.9
- foreign exchange	514,188.0	686,516.1	674,451.8	622,606.4	721,767.8
- other reserve assets	290.6	16,223.2	90.2	125.7	76.4
Liabilities	1,789,030.7	1,977,177.7	2,064,768.3	2,360,031.1	2,636,310.8
Direct investment in the Czech Republic	982,335.0	1,165,529.1	1,161,783.6	1,261,710.9	1,427,571.1
- equity capital	837,537.3	1,013,102.9	1,009,391.8	1,106,150.9	1,260,091.1
- other capital	144,797.7	152,426.2	152,391.8	155,560.0	167,480.0
Portfolio investment	180,346.2	201,120.0	223,620.4	381,019.4	446,950.2
- equity securities	128,740.1	128,097.7	140,788.6	208,872.1	221,943.4
- debt securities	51,606.1	73,022.3	82,831.8	172,147.3	225,006.8
Financial derivatives	11,495.2	22,671.9	19,448.3	31,811.3	37,922.4
Other investment	614,854.3	587,856.7	659,916.0	685,489.5	723,867.1
long-term	332,593.2	326,321.3	360,279.2	372,377.2	402,869.8
- CNB	133.4	114.5	96.1	70.2	47.8
- commercial banks	73,688.6	63,541.0	58,056.3	52,020.9	53,208.1
- government	9,476.2	9,475.8	22,456.0	32,065.4	50,853.9
- other sectors	249,295.0	253,190.0	279,670.8	288,220.7	298,760.0
short-term	282,261.1	261,535.4	299,636.8	313,112.3	320,997.3
- CNB	68.5	44.2	22.8	866.5	2,632.5
- commercial banks	190,487.6	176,196.2	208,534.0	185,565.8	170,904.8
- government	—	—	—	—	—
- other sectors	91,705.0	85,295.0	91,080.0	126,680.0	147,460.0
Net investment position	-244,067.7	-397,254.8	-527,483.7	-824,990.3	-851,408.8

1) Preliminary data

Table 14

EXTERNAL DEBT					in CZK millions
	2001 31 Dec.	2002 31 Dec.	2003 31 Dec.	2004[1)] 31 Dec.	2005[1)] 30 Sep.
Debt in convertible currencies	811,258.1	813,305.2	895,139.6	1,013,196.8	1,116,353.9
of which:					
Long-term	465,687.8	498,833.8	535,995.9	631,667.2	723,082.0
by debtor					
- CNB	133.4	114.5	96.1	70.2	47.8
- commercial banks	88,401.4	80,063.7	73,276.4	64,346.6	67,205.5
- government	30,839.2	47,701.3	69,029.9	147,729.1	216,975.1
- other sectors	346,313.8	370,954.3	393,593.5	419,521.3	438,853.6
by creditor					
- foreign banks	229,305.5	230,589.8	251,535.3	263,931.4	270,864.0
- 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	99,359.2
- suppliers and direct investors	105,944.3	118,829.4	109,287.9	108,720.0	118,210.0
- other investors	57,185.4	77,772.7	91,393.1	174,153.4	225,012.8
Short-term	345,570.3	314,471.4	359,143.7	381,529.6	393,271.9
by debtor					
- CNB	68.5	44.2	22.8	866.5	2,632.5
- commercial banks	192,438.4	177,474.4	210,017.0	189,036.5	173,324.7
- government	465.0	761.0	710.0	3,334.6	2,816.0
- other sectors	152,598.4	136,191.8	148,393.9	188,292.0	214,498.7
by creditor					
- foreign banks	192,126.4	168,200.7	218,436.1	208,032.3	186,422.3
- multilateral institutions	—	—	—	861.3	2,625.1
- suppliers and direct investors	116,278.4	112,256.8	105,563.9	130,000.0	145,370.0
- other investors	37,165.5	34,013.9	35,143.7	42,636.0	58,854.5
Debt in non-convertible currencies	—	—	—	—	—
of which:					
- long-term	—	—	—	—	—
- short-term	—	—	—	—	—
Total external debt	811,258.1	813,305.2	895,139.6	1,013,196.8	1,116,353.9
of which:					
- long-term	465,687.8	498,833.8	535,995.9	631,667.2	723,082.0
- short-term	345,570.3	314,471.4	359,143.7	381,529.6	393,271.9
Total long-term debt	465,687.8	498,833.8	535,995.9	631,667.2	723,082.0
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	275,002.1	333,454.9
- liabilities of entities with majority private capital	262,585.5	291,508.6	313,875.0	356,665.1	389,627.1

1) Preliminary data

Table 15

EXCHANGE RATES

in CZK; foreign exchange market rates

A. NOMINAL RATE	2001 1 - 12	2002 1 - 12	2003 1 - 12	2004 1 - 12	2005 10 - 12
CZK exchange rate against selected currencies					
- annual/quarterly averages					
1 EUR	34.08	30.81	31.84	31.90	29.30
1 USD	38.04	32.74	28.23	25.70	24.66
100 SKK	78.68	72.22	76.75	79.69	76.14
	12	**12**	**12**	**12**	**12**
- monthly averages					
1 EUR	32.59	31.19	32.31	30.65	28.98
1 USD	36.48	30.65	26.32	22.87	24.44
100 SKK	75.61	74.67	78.57	78.81	76.51
	31 Dec.	**31 Dec.**	**31 Dec.**	**31 Dec.**	**30 Dec.**
- last day of the month					
1 EUR	31.98	31.60	32.41	30.47	29.01
1 USD	36.26	30.14	25.65	22.37	24.59
100 SKK	74.81	75.18	78.71	78.63	76.57

B. NOMINAL EFFECTIVE RATE	2001	2002	2003	2004	2005
CZK nominal effective exchange rate (percentages)					
(2000=100)					
weights - foreign trade turnover	104.3	116.5	116.0	116.3	123.5
weights - foreign trade turnover SITC 5-8	104.4	116.1	115.6	115.5	122.8

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

C. REAL EFFECTIVE RATE	2001	2002	2003	2004	2005 11
CZK real effective exchange rate (percentages)					
(2000=100)					
a) industrial producer prices					
weights - foreign trade turnover	104.3	115.2	111.3	114.0	118.3
weights - foreign trade turnover SITC 5-8	104.9	115.9	112.0	115.4	120.8
b) consumer prices					
weights - foreign trade turnover	105.5	116.7	112.9	113.0	120.4
weights - foreign trade turnover SITC 5-8	106.2	117.5	113.7	114.1	122.3

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

Table 16

PUBLIC FINANCES					in CZK billions
	2001 1 - 12	2002 1 - 12	2003 1 - 12	2004 1 - 12	2005 1 - 12
STATE BUDGET					
Total revenue	626.2	705.0	699.7	769.2	866.5
Tax revenue	598.3	627.4	667.5	716.7	770.4
Taxes on income, profits and capital gains	147.4	159.0	172.9	180.7	195.0
Domestic taxes on goods and services	187.0	186.9	198.4	223.2	250.4
- value-added taxes	121.3	118.1	125.6	140.4	146.8
- excises	65.7	68.9	72.9	82.8	103.6
Taxes on property	6.4	7.9	8.8	10.4	8.1
Social and health security contributions and payroll taxes	242.3	258.5	272.4	293.3	311.2
Non-tax and capital incomes and received subsidies	27.9	77.7	32.2	52.5	96.1
Total expenditure	693.9	750.8	808.7	862.9	922.8
Current expenditure	642.5	697.3	745.4	796.8	840.8
Capital expenditure	51.4	53.5	63.3	66.1	82.0
Public budgets (balance in IMF GFS methodology) [1]	-48.8	-11.5	-129.4	-90.4	__
state budget	-63.3	-45.7	-106.6	-65.0	-56.3
local budget	-11.2	-4.3	-2.9	-8.9	__
state financial assets	__	__	__	__	__
state funds	-1.7	12.3	6.9	-10.7	__
Land Fund	-0.1	-0.5	-0.1	-4.2	__
National Property Fund	26.1	28.4	-27.4	-1.8	__
health insurance companies	1.4	-1.2	0.1	0.2	__
others	0.0	-0.5	0.6	0.0	__

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

Table 17

CAPITAL MARKET

last day of the month in points

A. STOCK MARKET INDICES	2001 12	2002 12	2003 12	2004 12	2005 12
BCPP					
PX 50	394.6	460.7	659.1	1,032.0	1,473.0
PX-D	1,065.6	1,166.4	1,642.7	2,551.1	3,731.4
PX-GLOB	492.9	576.8	816.9	1,232.7	1,811.3
RM-SYSTÉM					
PK-30	593.0	672.5	947.5	1,443.5	2,365.0

in CZK millions

B. TRADE VOLUMES	2001 12	2002 12	2003 12	2004 12	2005 12
BCPP					
Monthly trade volumes	142,803.6	109,264.8	98,640.0	90,610.5	96,160.5
of which:					
a) shares	12,819.3	17,089.3	28,296.0	46,210.3	56,180.3
b) units	4.3	0.0	0.0	0.0	0.0
c) bonds	129,980.0	92,175.5	70,344.0	44,400.2	39,980.2
RM-SYSTÉM					
Monthly trade volumes	2,162.5	4,412.1	1,103.0	335.8	286.7
of which:					
a) shares	1,841.0	298.4	1,082.5	332.7	220.9
b) units	212.2	1.0	3.7	3.1	0.0
c) bonds	109.3	4,112.7	16.8	0.0	65.8

Table 18

CNB MONETARY POLICY INSTRUMENTS

	2W repo rate (%)	Discount rate (%)	Lombard rate (%)	Minimum reserve requirement for primary deposits (%)	
				Banks	Building societies and ČMZRB
1999					
18 January	8.75	—	—	—	—
28 January	—	—	—	5.0	—
29 January	8.00	—	—	—	—
12 March	7.50	6.0	10.0	—	—
9 April	7.20	—	—	—	—
4 May	6.90	—	—	—	—
25 June	6.50	—	—	—	—
30 July	6.25	—	—	—	—
3 September	6.00	5.5	8.0	—	—
5 October	5.75	—	—	—	—
7 October	—	—	—	2.0	2.0
27 October	5.50	5.0	7.5	—	—
26 November	5.25	—	—	—	—
2000	No changes made				
2001					
23 February	5.00	4.0	6.0	—	—
27 July	5.25	4.25	6.25	—	—
30 November	4.75	3.75	5.75	—	—
2002					
22 January	4.50	3.50	5.50	—	—
1 February	4.25	3.25	5.25	—	—
26 April	3.75	2.75	4.75	—	—
26 July	3.00	2.00	4.00	—	—
1 November	2.75	1.75	3.75	—	—
2003					
31 January	2.50	1.50	3.50	—	—
26 June	2.25	1.25	3.25	—	—
1 August	2.00	1.00	3.00	—	—
2004					
25 June	2.25	1.25	3.25	—	—
27 August	2.50	1.50	3.50	—	—
2005					
28 January	2.25	1.25	3.25	—	—
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 Q3
Gross domestic product					
- in CZK millions	1,617,894	1,641,996	1,694,684	1,774,184	477,355
- percentages	2.6	1.5	3.2	4.7	4.9
Final consumption					
- in CZK millions	1,215,582	1,255,918	1,310,914	1,329,994	346,909
- percentages	3.0	3.3	4.4	1.5	3.8
of which:					
Households					
- in CZK millions	851,305	874,649	915,270	945,107	249,538
- percentages	2.8	2.7	4.6	3.3	2.9
Government					
- in CZK millions	355,593	371,673	385,895	375,614	95,312
- percentages	3.8	4.5	3.8	-2.7	6.1
Non-profit institutions					
- in CZK millions	8,793	9,506	9,807	10,915	2,860
- percentages	-12.3	8.1	3.2	11.3	3.6
Gross capital formation					
- in CZK millions	534,349	552,819	559,901	604,291	156,412
- percentages	6.3	3.5	1.3	7.9	-3.9
of which:					
Fixed capital					
- in CZK millions	507,629	524,964	549,815	578,984	152,134
- percentages	5.4	3.4	4.7	5.3	3.2
Changes in inventories					
- in CZK millions	26,627	27,731	9,931	25,205	4,243
Acquisitions less disposals of valuables					
- in CZK millions	93	124	155	102	35
- percentages	-43.8	33.0	25.7	-34.2	27.7
Foreign trade					
of which:					
Exports of goods					
- in CZK millions	1,109,034	1,175,324	1,294,538	1,593,388	441,004
- percentages	14.4	6.0	10.1	23.1	12.5
Exports of services					
- in CZK millions	192,798	162,181	151,004	167,362	44,485
- percentages	-1.2	-15.9	-6.9	10.8	0.8
Imports of goods					
- in CZK millions	1,244,593	1,302,315	1,418,198	1,698,450	448,330
- percentages	14.7	4.6	8.9	19.8	7.3
Imports of services					
- in CZK millions	201,328	214,620	217,569	237,116	60,765
- percentages	3.3	6.6	1.4	9.0	-2.7
Final domestic demand					
- in CZK millions	1,723,211	1,780,882	1,860,729	1,908,978	499,043
- percentages	3.7	3.3	4.5	2.6	3.6
Aggregate domestic demand					
- in CZK millions	1,749,931	1,808,737	1,870,815	1,934,285	503,321
- percentages	4.0	3.4	3.4	3.4	1.3
Gross domestic product at current prices					
- in CZK millions	2,315,255	2,414,669	2,555,783	2,767,717	742,824
- percentages	7.7	4.3	5.8	8.3	5.0

Source: CZSO

Table 20

LABOUR MARKET

annual percentage changes

A. NATIONAL ACCOUNTS FOR THE HOUSEHOLD SECTOR	2001 Q1 - 4	2002 Q1 - 4	2003 Q1 - 4	2004 Q1 - 4	2005 Q3
Current income	5.7	6.4	5.9	5.3	5.2
of which:					
- gross operating surplus and mixed income	8.3	2.4	7.7	6.4	2.2
- compensation of employees	6.8	8.5	5.5	6.1	6.0
- property income	0.8	-0.9	5.3	0.3	4.0
- social benefits other than social transfers in kind	4.6	8.0	3.6	3.6	5.8
- other current transfers	-9.0	4.1	10.9	2.3	10.9
Current expenditure	6.6	8.4	9.5	6.6	8.5
of which:					
- property income	1.7	15.1	21.3	11.7	12.5
- current taxes on income, wealth, etc.	5.9	8.2	12.1	6.3	10.2
- social contributions	6.8	8.9	7.2	7.8	8.1
- other current transfers	8.5	4.7	12.5	0.2	6.5
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	12.1
Individual consumption expenditure	6.4	3.5	6.5	5.5	4.4
Gross saving	-4.7	31.8	-15.5	-1.6	-4.5
Gross saving rate	7.93	9.90	8.03	7.54	5.67
(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 Q3
Whole-economy nominal wage	8.1	7.0	6.4	6.2	6.1
Business sector	7.7	6.3	5.5	6.3	5.6
Non-business sector	9.6	9.8	9.8	5.7	8.6
Whole-economy real wage	3.2	5.1	6.3	3.3	4.1
Business sector	2.9	4.4	5.4	3.4	3.6
Non-business sector	4.7	7.9	9.7	2.8	6.6

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

	2001	2002	2003	2004	2005
Industrial producer prices					
a) previous month = 100	0.1	-0.1	0.1	0.6	0.0
b) same period of last year = 100	2.9	-0.5	-0.3	5.7	3.0
c) average for 2000 = 100	2.8	2.3	1.9	7.7	10.9
d) December 1999 = 100	6.3	5.8	5.4	11.4	14.7
Construction work prices					
a) previous month = 100	0.3	0.2	0.2	0.4	0.2
b) same period of last year = 100	4.1	2.7	2.2	3.7	3.0
c) average for 2000 = 100	4.1	6.9	9.2	13.3	16.6
d) December 1999 = 100	6.5	9.3	11.7	15.8	19.3
Agricultural producer prices					
b) same period of last year = 100	8.4	-9.5	-2.9	8.1	-9.2
of which:					
crop products					
b) same period of last year = 100	9.3	-4.6	-1.0	11.6	-25.0
livestock products					
b) same period of last year = 100	8.0	-12.1	-4.0	6.1	0.4
Market services prices					
a) previous month = 100	0.1	0.3	0.0	0.2	0.1
b) same period of last year = 100	3.9	3.2	1.6	2.3	1.9
c) average for 2000 = 100	4.0	7.3	9.0	11.5	13.7
d) December 1999 = 100	4.6	8.0	9.7	12.2	14.4

Source: CZSO

Table 22

RATIOS OF KEY INDICATORS TO GDP					percentage ratios
	2000	**2001**	**2002**	**2003**	**2004**
Public budgets balance	-2.9	-2.1	-0.5	-5.1	-3.3
Public debt	15.5	17.5	18.4	21.6	23.8
Debt in convertible currencies	37.6	35.0	33.7	35.0	36.6
Trade balance [1)]	-5.6	-5.0	-3.0	-2.7	-0.8
Current account balance	-4.9	-5.4	-5.6	-6.3	-5.2
M2	65.7	68.9	68.4	69.1	66.6

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

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