INFLATION REPORT / JULY

2006

CNB CZECH NATIONAL BANK

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ABBREVIATIONS USED

ARA	Amsterdam-Rotterdam-Antwerp
BCPP	Prague Stock Exchange
CCA	Czech Consolidation Agency
CF	Consensus Forecasts
ČMZRB	Czech-Moravian Guarantee and Development Bank
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
GDP	gross domestic product
GFS	Government Finance Statistics
HICP	Harmonised Index of Consumer Prices
IMF	International Monetary Fund
IRS	interest rate swap
LFS	Labour Force Survey
LIBOR	London Interbank Offered Rate
M1, M2	monetary aggregates
MD	Ministry of Defence
MF	Ministry of Finance
MFIs	monetary financial institutions
MI	Ministry of the Interior
MLSA	Ministry of Labour and Social Affairs
NBS	National Bank of Slovakia
NCG	net credit to government
NDAs	net domestic assets
NEAs	net external assets
NPISHs	non-profit institutions serving households
OMFIs	other monetary financial institutions
O/N	overnight
PPI	producer price index
PRIBID	Prague Interbank Bid Rate
PRIBOR	Prague Interbank Offered Rate
(1W, 1M, 1Y)	(one-week, one-month, one-year)
repo rate	repurchase agreement rate
SFAOs	state financial assets operations
SITC	Standard International Trade Classification
SKK	Slovak koruna
USD	US dollar
VAT	value added tax
WTI	West Texas Intermediate crude oil

In 1998, the Czech National Bank switched to direct inflation targeting. In the inflation targeting regime, the central bank's communication with the public plays a significant role. One of the core elements of this communication is the publishing of quarterly 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 entirely to the message of the forecast. Information on the Bank Board's discussions over the past three months and on the reasons for its monetary policy measures in that period is given in the minutes of the Bank Board meetings at the end of this Inflation Report.

This Inflation Report was approved by the CNB Bank Board on 3 August 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 close to the point inflation target in 2006 Q2
(annual percentage changes in CPI)

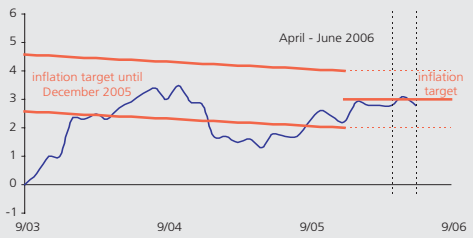


Table I.1
The Czech economy grew at its fastest ever rate in 2006 Q1
(annual percentage changes unless otherwise indicated)

	3/06	4/06	5/06	6/06
Consumer price inflation	2.8	2.8	3.1	2.8
Industrial producer price inflation	0.3	0.5	1.5	1.8
Money supply growth (M2)	9.0	9.0	7.9	-
3M PRIBOR[a)] (in per cent)	2.1	2.1	2.1	2.2
Nominal CZK/EUR exchange rate[a)] (level)	28.65	28.51	28.27	28.39
State budget balance since January incl. SFAOs[b)] (CZK bn)	15.7	-20.0	-12.2	7.6
GDP growth at constant prices[c)]	7.4			-
Unemployment rate[b)] (in per cent)	8.8	8.3	7.9	7.7

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

Since the start of this year, including Q2, consumer price inflation has been close to the point inflation target (see Chart I.1). The growth of the Czech economy continued to surge, reaching a new historical high. Higher demand for labour generated growth in wages and a further modest decline in registered unemployment. Market interest rates increased at the longer end of the yield curve in 2006 Q2. The koruna's exchange rate against both major currencies was stronger in this period than in the previous quarter.

Consumer prices recorded the same annual rate of growth in April and June as in the final two months of Q1 (2.8%). In May, the growth rate was 0.3 percentage point higher. The pick-up in inflation in May was due mainly to telephone charges and fuel prices. The June slowdown was due primarily to base effects in the area of telecommunication services and fuels. Food prices had the opposite effect, recording a modest rise after six months of year-on-year declines. The reversal in trend for food prices was caused mainly by marked increases in bread, fruit and potato prices. Regulated prices, and in particular energy prices, accounted for more than three-quarters of the annual consumer price inflation in Q2.

According to preliminary CZSO estimates, GDP growth exceeded the 7% level in 2006 Q1. Revisions were simultaneously made to the figures for 2004 (downwards) and 2005 (upwards). Year-on-year growth in fixed investment and inventories contributed significantly to the economic growth recorded in 2006 Q1. The external sector retained its significant position owing to a persisting (albeit slightly falling) lead of goods and services export growth over import growth. The growth of the Czech economy was also fostered by household consumption. The contribution of government consumption was slightly negative.

The continuing buoyant growth of the Czech economy created the right conditions for rising employment, whose growth picked up again slightly in 2006 Q1. As in the previous period, however, the increased demand for labour was met partly outside the labour office register, so registered unemployment continued falling more slowly than would correspond to the changes in employment. Corporations' growing demand for labour fostered a rise in year-on-year nominal and real wage growth, particularly in the business sector.

Short-term interest rates on the money market were broadly stable in 2006 Q2. Except in May, when a temporary correction occurred, interest rates gradually increased at the longer end of the yield curve. This was due in particular to expectations regarding the timing of an increase in the CNB's key interest rates, which stemmed, in turn, from the CNB's press conferences and Bank Board minutes, the published economic indicators and an expected hike in euro area interest rates.

The koruna's exchange rate against both major currencies appreciated in the first two months of Q2, reaching historical highs against the euro at the end of May and against the dollar at the beginning of June. This was due primarily to favourable data on the Czech economy and to a weakening of the dollar. In June, the koruna depreciated slightly against both these currencies. The appreciation trend was halted in particular by higher yields in the euro area and the USA and by a downturn in investor sentiment regarding developments in the Central European region and the emerging markets in general.

The monetary policy decision-making of the CNB Bank Board in 2006 Q2 was based on the inflation forecast discussed by the Board at its meeting on 25 April 2006 and published in the April Inflation Report. Given the monetary policy transmission lag, the Board focused on hitting the inflation target at roughly the 12–18 month horizon, i.e. in the second and third quarters of 2007. According to the forecast, inflation in this period should initially lie very close to the CNB's point inflation

target and then increase above it. Consistent with the baseline scenario was interest rate stability initially and a gradual rise in rates thereafter.

The Bank Board made no changes to monetary policy interest rates during 2006 Q2. This was consistent with the forecast and the related risks, which the Bank Board assessed as moderate and broadly balanced. The decision of the Bank Board to leave interest rates unchanged was unanimous at all three meetings. The main downside risk to inflation identified by the Bank Board was the evolution of the koruna exchange rate. The main upside risk, according to the Bank Board, was the higher-than-forecasted oil price, although its impact on domestic prices is being dampened by the weaker exchange rate of the dollar.

Section IV of this Inflation Report describes the CNB's new forecast. New data on domestic economic activity led to a revision of the output gap towards a more inflationary effect. A tighter exchange rate component of the monetary conditions and a weak external recovery will counteract any further growth of the output gap, but a gradual easing of the monetary conditions and expected fiscal developments will help to keep it in positive values. The inflation forecast for 2006 and 2007 has been increased slightly. This change reflects a re-assessment of the outlook for food and administered prices and a higher-than-expected inflationary effect of cost and demand factors. At the monetary policy horizon, inflation lies very close to the upper boundary of the toleration band of the point inflation target.

The mechanism of caveats applies as usual 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 is very close to the point inflation target at the monetary policy horizon. Consistent with macroeconomic forecast and its assumptions is a gradual rise in interest rates.

Along with the baseline scenario of the forecast, an alternative scenario was drawn up using the core prediction model extended to include wage costs in conditions of sticky nominal wages. This alternative scenario deals with the general risk associated with correctly identifying inflationary pressures from the real economy. Taking into account the effect of real wages, the alternative scenario identifies lower inflationary pressures, leading, in turn, to lower growth in inflation and slightly lower, but still rising, interest rates than in the baseline scenario.

Chart I.2
The inflation forecast is close to the upper boundary of the tolerance band of the point inflation target at the monetary policy horizon
(annual percentage changes in CPI)

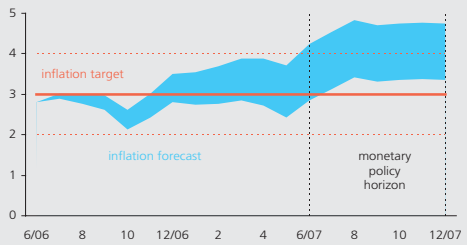


Chart I.3
Excluding the first-round impacts of indirect taxes, inflation is very close to the point inflation target at the monetary policy horizon
(annual percentage changes)

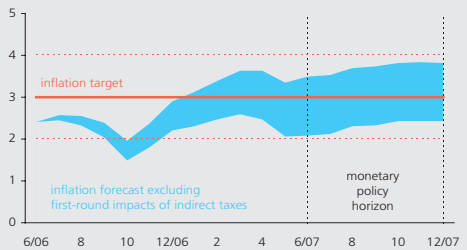


Chart II.1
Except in May, inflation was flat in 2006 Q2
(percentages)

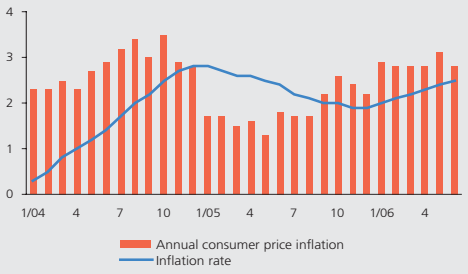


Table II.1
Housing expenditure rose the fastest in 2006 Q2
(annual percentage changes)

	12/05	1/06	2/06	3/06	4/06	5/06	6/06
Consumer prices	2.2	2.9	2.8	2.8	2.8	3.1	2.8
Food and non-alcoholic beverages	-0.9	-0.5	-0.7	-0.7	-0.4	-0.3	0.9
Alcoholic beverages and tobacco	0.7	0.8	0.8	0.9	1.1	1.5	1.1
Clothing and footwear	-6.6	-5.9	-5.9	-5.9	-6.1	-6.2	-6.5
Housing, water, electricity, gas and other fuels	5.1	7.0	7.0	7.0	7.3	7.4	7.4
Furnishings, household equipment and routine maintenance of the house	-1.8	-1.7	-1.5	-1.6	-1.4	-1.4	-1.5
Health	7.4	4.3	4.1	4.4	4.3	3.9	3.7
Transport	3.6	4.4	4.8	4.2	3.1	4.2	3.2
Communication	14.1	14.7	13.2	13.2	10.9	17.2	1.4
Recreation and culture	2.4	2.0	1.7	1.8	2.3	2.1	1.4
Education	1.8	4.5	4.0	3.7	3.7	3.7	3.9
Hotels and restaurants	2.7	2.7	2.5	2.4	2.4	2.6	2.7
Miscellaneous goods and services	0.5	1.3	1.3	1.5	1.7	1.8	1.8

Chart II.2
Housing expenditure accounted for almost three-quarters of the rise in consumer prices
(contributions in percentage points; June 2006)

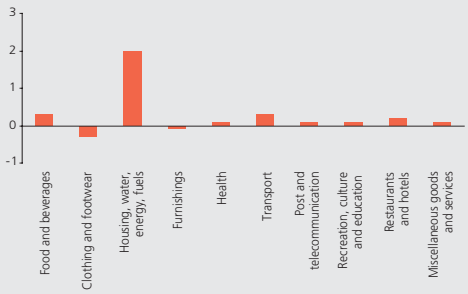
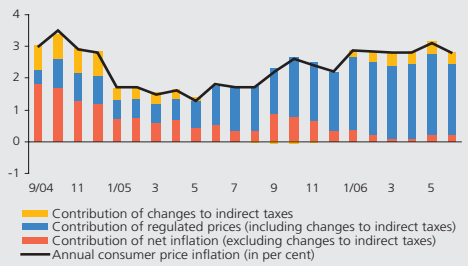


Chart II.3
Consumer price inflation was again affected most strongly by regulated prices in 2006 Q2; the effect of market prices was small
(annual percentage changes; contributions in percentage points)



II.1 PAST INFLATION DEVELOPMENTS

Annual inflation[1] was broadly flat in 2006 Q2 at the previous quarter's level. It rose by 0.3 percentage point to 3.1% in May, but according to the latest data for June it then returned to its previous value of 2.8%. The inflation rate[2] rose in Q2 to stand at 2.5% in June.

The pick-up in annual consumer price inflation in May was due mainly to rising regulated telephone charges and fuel prices. These sizeable price changes fostered a rise in consumer price inflation in the categories of postal services and telecommunication and transport. The June slowdown in annual price inflation to the previous level of 2.8% resulted from contrary price movements in several categories of the consumer basket. It was due primarily to base effects in the area of telecommunication services and also to slowing fuel price growth connected with oil price volatility on world markets. These downward effects on inflation were counteracted by an upswing in food prices. However, the main factor underlying the annual consumer price inflation in June, as in previous months of 2006, was fast growing prices in the housing category, which accounted for almost three-quarters of the total. The contribution of food and fuel prices was markedly lower (see Chart II.2).

As in previous quarters, domestic prices were affected in Q2 by the fast growing prices of imported energy-producing materials. However, they had a major effect only on producer prices at the initial stages of the product chain. Prices of other imported commodities mostly decreased, creating conditions for only slight producer price growth, although in some import groups their anti-inflationary effect weakened. Industrial producer price inflation increased, but remained relatively subdued. Inflation growth was also depressed by rapid productivity growth accompanied by a falling personnel cost-output ratio. Nevertheless, a gradual pick-up in inflation in some branches of manufacturing and a more marked increase in some market services prices indicated the effect of higher demand in conditions of buoyant economic growth.

By the CNB's estimation, the economy exceeded its potential, non-accelerating inflation level of output in 2006 Q1. Consumer demand growth rose in 2006 Q1. Households' consumption expenditure increased amid a slight year-on-year rise in the saving rate. However, consumer prices had yet to indicate any pronounced demand-pull effect. Sizeable effects of the rapidly rising prices of energy-producing commodities were visible only in consumer prices of fuels, housing and partly also food prices (bread products).

In these circumstances, annual growth in market prices remained low in 2006 Q2 (0.3% in June).[3] The main source of consumer price inflation was regulated prices, particularly energy prices for households and telecommunication charges. The modest rise in market prices stemmed solely from growth in prices in the category of non-food commodities (of 0.7% year on year), which was largely due to fuel prices. Conversely, food prices excluding changes to excise duties continued falling year on year during Q2 (by 0.6% in June).

However, including changes to excise duties food prices started rising in Q2, recording growth of 1% in June. The main factor underlying the rise in food prices

[1] Measured by annual growth in consumer prices.
[2] The inflation rate expressed as the increase in the average consumer price index (basic) for the last 12 months relative to the average for the previous 12 months.
[3] Excluding changes to indirect taxes.

was a gradual moderation of the annual decline in domestic agricultural producer prices, which, owing to a rise in crop product prices, turned into renewed year-on-year growth in March. According to the data for April and May, imported food also recorded a renewed rise in prices. However, the upturn in food prices was not across the board in nature and concerned only a small number of groups, including, besides the traditionally very volatile prices of vegetables and potatoes, bread products. The rise in bread prices was probably due not only to rising prices of production inputs (energy, grain) but also to a stronger bargaining position of producers in this industry in relation to large retailers.

Food prices in other categories continued to decline or showed only modest annual growth. The increase in excise duties on cigarettes and tobacco products[4] passed through to food prices with a significant lag, due to stocks being sold off at their original price. Overall, however, cigarette prices increased by much less than would correspond to the increase in excise duties. For the same reasons, the further increase in excise duties on cigarettes with effect from April 2006 had yet to pass through to food prices.

Annual growth in prices of non-food commodities[5] was moderate overall in 2006 Q2, fluctuating mostly around 1%. The lowest figure was recorded in June, when it dropped to 0.7%. However, these prices continued to show very mixed structural trends, owing to the considerable diversity of the key factors affecting prices in the individual components of this price index. The fastest growth was displayed by fuel prices, which tend to respond to changes in oil prices on world markets with a lag. Chart II.5 shows that the pick-up in their growth, despite some volatility, did not continue in Q2. At 8.3%, their year-on-year growth was 2.6 percentage points lower than at the end of the previous quarter.

The year-on-year decline in prices of other tradable commodities (except fuels and food), which are affected above all by the external competitive environment, continued into 2006 Q2. After a five-month stagnation at 2.1%, this decline accelerated to 2.9% in June. The falling prices in this category are a long-term phenomenon that has been ongoing since the beginning of 2001. The main factor underlying the current decline in prices of these commodities was the relatively strong year-on-year appreciation of the koruna-euro exchange rate combined with the relatively low prices of many consumer products on foreign markets, which resulted in mostly falling prices of imports of consumer goods. As in previous quarters, declining prices were recorded particularly in the categories of clothing and footwear and household equipment and furnishings.

Prices of non-tradable market commodities are predominantly affected by the domestic competitive environment and consist primarily of services provided in the Czech Republic. Their subdued growth continued into 2006 Q2, falling to 2.2%. They developed broadly in line with wages and consumer demand, although higher price growth was recorded in some categories of services (education, for example).

Regulated prices again rose very fast in 2006 Q2, their annual growth remaining above 10% (10.5% in June). The buoyant growth in regulated prices in 2006 H1 was due mainly to a January increase in energy prices for households and a May increase of almost 12% in regulated telephone charges. The rise in regulated prices was also fostered by an increase in gas prices of 1.4% in April 2006. Other

CHART II.4
Food prices started rising again in 2006 Q2
(annual percentage changes)

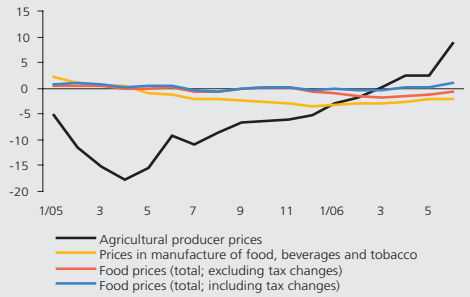


CHART II.5
Prices of fuels were the fastest growing among the non-food commodities
(annual percentage changes, including changes to indirect taxes)

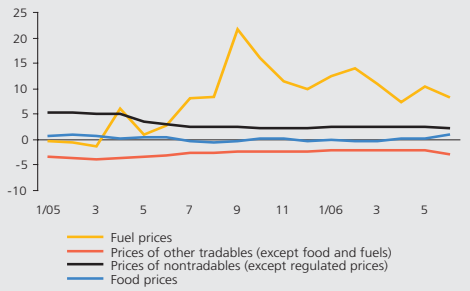


CHART II.6
The high growth in regulated prices was due primarily to rising prices of energy sources for households in 2006 Q1
(annual percentage changes)

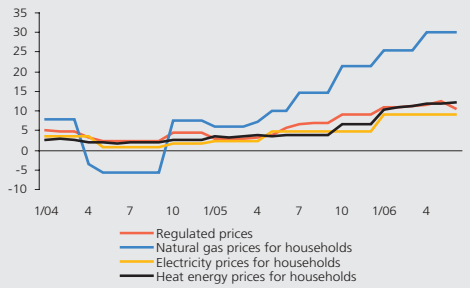
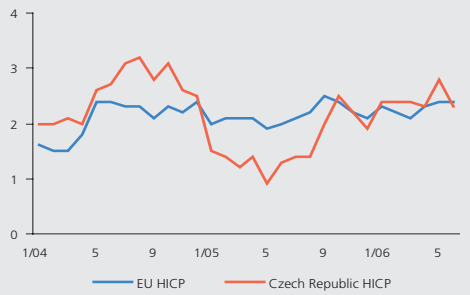


CHART II.7
Inflation in the Czech Republic was usually slightly higher than in the EU countries in 2006 H1
(annual percentage changes)



[4] With effect from 1 July 2005.

[5] Consolidated category of prices of non-food commodities, comprising tradable commodities, non-tradable commodities and fuels.

regulated items recorded only minor movements with minimal impacts on inflation. The slower growth in regulated prices in June was due to base effects.

Turning to international comparisons, annual HICP inflation in the Czech Republic started to fluctuate above that in the EU countries at the start of 2006. A closer look at the structure of the HICP in the Czech Republic and in other EU countries reveals that this difference was mainly due to significantly higher growth in the categories of housing and telecommunication services. Annual HICP inflation in the Czech Republic fell markedly in June (to 2.3%), whereas in the EU countries remained at the May level of 2.4%.

II.2 FULFILMENT OF THE INFLATION TARGET

Headline inflation was very close to the CNB's point inflation target in 2006 Q2 (see Chart I.1). This section of the Inflation Report briefly analyses the contribution of the CNB's monetary policy to this situation.

Changes to interest rates pass through into inflation most strongly with a lag of around 12 to 18 months. Accordingly, to assess the effect of monetary policy on the fulfilment of the inflation target in 2006 Q2, one needs to analyse retrospectively the forecasts, and the Bank Board's decisions based thereon, dating roughly from October 2004 to June 2005. For comprehensibility, the analysis of the accuracy of the forecasts is limited here to a comparison of the forecast drawn up in January 2005, i.e. approximately in the middle of the aforementioned period, with inflation in 2006 Q2 (see Table II.2).

The January 2005 forecast had predicted easy monetary policy in both the interest rate and exchange rate components of the monetary conditions. This prediction, together with flat external demand, led to a forecast of only slow closure of the negative output gap, which was expected to move into positive figures at the beginning of 2006. Changes to indirect taxes and regulated prices were also expected to join the inflationary effect of the closing output gap. To sum up, the January forecast predicted a slight increase in inflation, which at the monetary policy horizon was expected to be close to the CNB's point inflation target. Actual inflation developed roughly in line with the January forecast over the entire forecast horizon (see Chart II.8). However, a closer look at the inflation structure reveals that the individual components of inflation differed from the January forecast. Food prices, adjusted inflation and changes to indirect taxes deviated downwards. By contrast, regulated prices and fuel prices were higher than forecasted.

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

Consistent with the January forecast was a slight decline in interest rates in 2005 H1. Rates were expected to start rising gradually in 2006 H1. The actual interest rate path was at the forecast level in 2005 Q1, but it subsequently deviated downwards. Interest rates were lowered three times by a total of 0.75 percentage point during 2005 H1 and then raised by 0.25 percentage point in October 2005. In the key period as regards the most recent consumer price developments, i.e. in 2004 Q4 and 2005 H1, nominal interest rates were slightly lower than forecasted. Nevertheless, interest rates in real terms were tighter than forecasted, owing to a

Table II.2
Headline inflation in 2006 Q2 was close to the January 2005 forecast
(annual percentage changes; contributions in percentage points)

	January 2005 forecast	2006 Q2 outturn	Contribution to total difference in perc. points [a]
Annual consumer price inflation	2.8	2.9	0.1
Breakdown into contributions:			
regulated prices	2.3	11.5	1.9
changes to indirect taxes	0.8	0.4	-0.4
food prices, excluding changes to indirect taxes	1.2	-1.1	-0.6
fuel prices, excluding changes to indirect taxes	-2.3	8.6	0.2
adjusted inflation excluding fuels, excluding changes to indirect taxes	2.4	0.4	-1.0

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

Chart II.8
Actual inflation was roughly in line with the January forecast over the entire forecast period
(annual percentage changes)

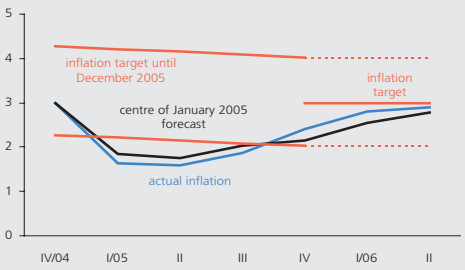


Table II.3
Of the exogenous factors, the price of oil deviated the most from the forecast

		I/05	II/05	III/05	IV/05	I/06	II/06
GDP Germany [a]	prediction	1.3	1.3	1.6	1.0	1.2	1.4
(annual perc. changes)	outturn	0.3	1.0	1.5	1.1	2.0	-
CPI in Germany	prediction	1.8	1.3	1.3	1.2	1.3	1.5
(annual perc. changes)	outturn	1.7	1.7	2.1	2.3	2.0	2.0
1Y EURIBOR	prediction	2.3	2.3	2.3	2.4	2.5	2.6
(percentages)	outturn	2.3	2.2	2.2	2.6	3.0	3.3
USD/EUR exchange rate	prediction	1.33	1.33	1.33	1.33	1.32	1.31
(levels)	outturn	1.31	1.26	1.22	1.19	1.20	1.26
Oil prices [b]	prediction	38.0	36.9	35.2	34.5	34.4	34.5
(USD/barrel)	outturn	42.8	47.6	57.3	53.3	57.6	64.9

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

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

An integral part of the assessment of the fulfilment of forecasts is a discussion of any changes in the CNB's view of the functioning of the economy since the forecast was prepared. The only significant change made to the forecasting system since January 2005 was the revision to the evolution of the equilibrium variables discussed above. This adjustment generates an easier exchange rate component and a tighter interest rate component of the monetary conditions, but it does not significantly change the view of the monetary conditions as a whole.

When assessing the fulfilment of the January 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 January 2005. These revisions, especially those made in March 2006, have markedly increased the estimate of GDP growth in 2004 and 2005. In the absence of any observable inflationary pressures, the revision of the national accounts has generated an increase of more than one percentage point in the estimated growth of the potential, non-accelerating inflation level of output. The initial output gap at the end of 2004 and the beginning of 2005 has meanwhile been revised towards a more anti-inflationary effect.

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

The output gap closed rapidly during 2005 and turned positive in 2006. Underlying this development was easy monetary policy, which outweighed the effects of the restrictive fiscal policy and weak external demand. Nevertheless, the narrower output gap compared to the January forecast did not translate into higher adjusted inflation excluding fuels, since its effect was outweighed by the price impacts of the greater-than-expected strengthening of the koruna. This strengthening, together with the above-average harvest in 2005, also fostered lower growth in food prices. The growth in world oil prices significantly exceeded the appreciation of the koruna-euro exchange rate and the euro-dollar exchange rate and had an inflationary effect. The effect of the higher oil prices is visible not only in higher-than-expected fuel prices, but also – via growth in energy prices for households – in higher regulated prices. The higher growth in regulated prices was also due to increases in prices of telecommunication services (not expected by the forecast) in June 2005 and May 2006. The deviations of the individual components of inflation from the January forecast offset each other overall. As a result, headline inflation was very close to the CNB's January forecast and point inflation target in Q2.

The inflation forecast is the primary source material for the Bank Board's decisions. Also of key importance is an assessment of the possible risks associated with this forecast by the board members. At the Board's meetings during 2004 Q4 and 2005 H1 (see the relevant minutes), the overall perception of the risks was slightly anti-inflationary (the October and April forecasts roughly neutral and the January forecast anti-inflationary). In line with this assessment, the Bank Board deviated somewhat towards lower rates from the recommendations of the forecast. One can say with the benefit of hindsight that the slightly lower nominal interest rates compared to the original assumptions contributed to inflation being close to the point inflation target in 2006 Q2.

Table II.4

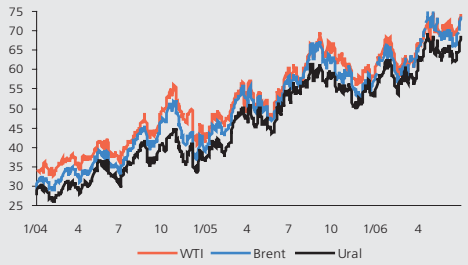
The koruna-euro exchange rate was stronger than expected

		I/05	II/05	III/05	IV/05	I/06	II/06
3M PRIBOR	prediction	2.4	2.3	2.3	2.4	2.4	2.6
(percentages)	outturn	2.3	1.9	1.8	2.1	2.1	2.1
CZK/EUR exchange rate	prediction	30.8	30.7	30.7	30.6	30.5	30.4
(levels)	outturn	30.0	30.1	29.7	29.3	28.6	28.4
GDP	prediction	3.5	3.7	4.0	4.1	3.9	4.0
(real, annual perc. changes)	outturn	5.4	6.1	5.9	6.9	7.4	-
Output gap	prediction	-0.5	-0.3	-0.2	-0.1	0.0	0.2
(percentages of GDP)	outturn[a)]	-0.8	-0.5	-0.2	0.3	0.8	0.9

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

III.1 THE EXTERNAL ENVIRONMENT

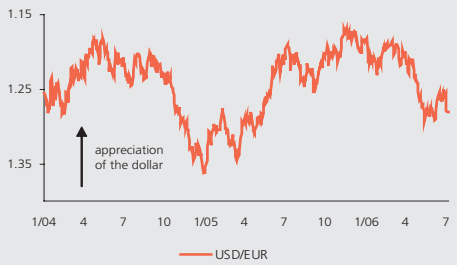
Chart III.1
The average price of Brent crude oil rose by 12.6% in 2006 Q2 compared to the previous quarter
(USD/barrel)



The rate of growth of the US economy rose slightly in 2006 Q1 and its lead over economic growth in the euro area increased. Economic growth in the Central European region accelerated further overall, with Slovakia and the Czech Republic being the fastest growing economies in the region. The US dollar depreciated against the euro in 2006 Q2 for the second consecutive quarter. The price of Brent crude oil fluctuated between USD 66.1 and USD 74.7 a barrel in this period, the average level being 12.6% higher than in Q1 (see the box on oil prices).

The US economy grew by 3.7% year on year in 2006 Q1, i.e. 0.5 percentage point faster than in the previous quarter. US economic growth thus again significantly outpaced that of the euro area. The favourable GDP growth was due in particular to buoyant household consumption and private investment (as a result of the still low real interest rates and high corporate earnings). The relatively high economic growth led to a further slight decline in the unemployment rate (to 4.6% in June, the lowest level since 2001).

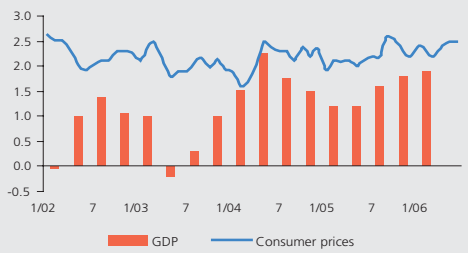
Chart III.2
The dollar depreciated by almost 5% in 2006 Q2 compared to the previous quarter



Annual consumer price inflation rose to 4.2% in May, i.e. by 0.7 percentage point relative to the previous month, mainly due to the high energy prices. Annual core inflation rose only slightly compared to the previous month, reaching 2.4%. Producer price inflation also increased – to 4.5% in May. The external imbalance of the USA continued to develop negatively. The current account deficit reached USD 209 billion in Q1, widening by USD 17 billion year on year. An increase in the trade deficit of USD 23 billion accounted for most of this result. The current account deficit as a percentage of GDP rose only slightly year on year, reaching -6.4%. At the end of June, the Fed raised its key rate by 0.25 percentage point for the fourth time, to 5.25%. According to the US central bank, high economic growth at the Q1 level could cause inflationary pressures to strengthen. At the same time, however, the bank sees signs of a gradual slackening of growth (due to a cooling of the real estate market and the lagged effect of the higher interest rates and energy and raw materials prices).

Annual GDP growth in the euro area recorded a further modest pick-up in 2006 Q1, rising by 0.3 percentage point compared to the previous quarter to 2.0%. The economic growth was driven by household consumption and fixed investment. The contribution of net exports to GDP growth remained neutral. The rising economic growth in the euro area for the third consecutive quarter started to have a positive effect on the unemployment rate. In May, the unemployment rate fell slightly month on month to 7.9% and was 0.7 percentage point lower than in the same period a year earlier.

Chart III.3
Economic growth in the euro area picked up further in 2006 Q1
(annual percentage changes)



Annual consumer price inflation in the euro area increased slightly in May, reaching 2.5%. However, the year-on-year growth in core inflation slackened compared to the previous month to 1.3%. Given the relatively moderate growth in labour costs, there was no emergence so far of second-round effects generated by the high energy prices. Industrial producer prices showed a year-on-year rise of 6.0%, the highest growth since 2000, primarily as a result of the high energy prices. Core producer price inflation also increased, to 2.7%, owing to high metal prices. The rapid rise in metal prices was another major factor causing mounting inflationary pressures in the euro area.

In 2006 Q1, the current account surplus changed into deficit (of EUR 10 billion), deteriorating by EUR 10.7 billion year on year. This change, however, was not a reflection of a worsening of the euro area's competitiveness, but was due to unfavourable price factors (high oil and natural gas prices and rising metal prices) resulting in a deteriorating trade balance. The trade balance ran a deficit of EUR 12.1 billion, a year-on-year deterioration of almost EUR 18 billion. The current

account deficit as a percentage of GDP was -0.5%. Given the expected inflationary pressures, the ECB raised its key rate by 0.25 percentage point in mid-June for the second time this year, to 2.75%. The ECB sees the risks primarily in excessively fast money supply growth (M3 increased by 8.9% year on year in May), rising administered prices and indirect taxes and the emergence of second-round effects of the high energy prices.

The countries of the Central European region maintained high economic growth above 4% in 2006 Q1, more than double that in the euro area. Slovakia, along with the Czech Republic, continued to grow the fastest, while Poland showed the lowest inflation. Trade balances and current accounts remained in deficit.

Economic growth in Hungary reached 4.6% in Q1, up slightly on the previous quarter (up by 0.3 percentage point). Nonetheless, Hungary's GDP growth was the lowest in the region. The structure of the growth remained virtually unchanged from the previous period. The GDP growth was driven mostly by favourable net exports and high growth in fixed investment. However, the rate of growth of household consumption was also faster than in the previous quarter. At 7.3%, the unemployment rate was somewhat lower in May than in the previous month. In year-on-year terms it was virtually unchanged and was still the lowest in the region.

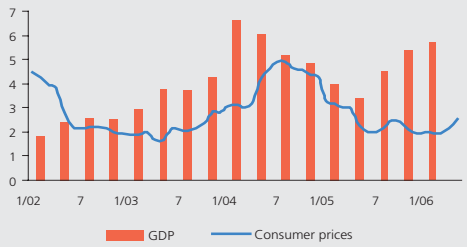
Consumer prices in Hungary rose by 2.8% year on year in June, the same figure as in May. This was mostly due to unfavourable energy prices. Industrial producer price inflation was 0.5 percentage point lower in May than in April, falling to 5.3%. This, however, can be considered a short-term fluctuation. The current account deficit as a percentage of GDP remained high in Q1 (-7.0%), but was slightly lower than a year earlier. By contrast, the trade deficit widened year on year. In mid-June, after eight months of no changes, the Hungarian central bank raised its key interest rate by 0.25 percentage point to 7.25% owing to the increased inflation risks. In the bank's opinion, the inflationary pressures are chiefly due to the fiscal measures currently under preparation, which have not had a positive reception from investors and have ultimately led to a fall in demand for Hungarian assets.

In Poland, economic growth gradually increased last year and reached 5.2% in 2006 Q1. This pick-up was mainly due to buoyant household consumption and, despite some moderation, to robust investment growth. The contribution of net exports was also positive. The unemployment rate decreased in May compared to the previous month, but stayed very high at 16.6% (down by 1.7 percentage points year on year).

At 0.9%, annual consumer price inflation was below the 1% level for the sixth consecutive month in May. Compared to the previous month, however, it increased somewhat. Industrial producer prices have been growing faster during the year and rose by 2.3% in May. The high growth in energy prices was dampened by appreciation of the exchange rate and slow wage growth relative to labour productivity growth. In Q2, the Polish central bank's Monetary Policy Committee left its key rate unchanged. Although inflation and wages were both rising somewhat faster than expected by the bank, the inflationary pressures remained weak.

GDP in Slovakia grew by 6.3% year on year in 2006 Q1. The growth was slightly slower than in the previous quarter, but Slovakia, together with the Czech Republic, was still the fastest growing economy in the region. The GDP growth was due to robust household consumption and, in roughly equal measure, to fixed investment. However, the growth rate continued to be slowed by a widening net export deficit. The high economic growth generated a further reduction in the unemployment rate, which fell well below 11% in May (to 10.6%).

Chart III.4
In the new EU Member States, GDP growth increased further in 2006 Q1
(annual percentage changes)

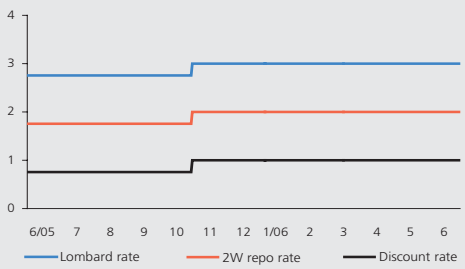


The strong domestic demand and high energy prices also generated continuing growth in the price level. Annual consumer price inflation increased to 4.8% in May, giving Slovakia the highest inflation in the region. Core inflation increased to 2.8% (up by 0.4 percentage point on the previous month). Annual industrial producer price inflation remained just below the 10% level for the fourth consecutive month (9.9% in May). The current account deficit as a percentage of GDP increased by 5.3 percentage points year on year to -7.6% in 2006 Q1. The current account deterioration was mostly due to an increase in the trade deficit caused by high investment imports. At the start of June, the NBS increased its key rate by 0.5 percentage point for the second time this year. This took the basic repo rate to 4.0%. This monetary policy tightening was aimed at eliminating both the demand-pull and cost-push inflationary risks.

III.2 THE MONETARY CONDITIONS

According to the CNB's calculations, the settings of the real monetary conditions in 2006 Q2 can be characterised as slightly tight. The tightness is due to the exchange rate component, i.e. the exchange rate appreciation in the last few quarters. By contrast, the interest rate component was neutral to slightly easy.[6] The evolution of the two components of the monetary conditions in 2006 Q2 is described in more detail below.

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

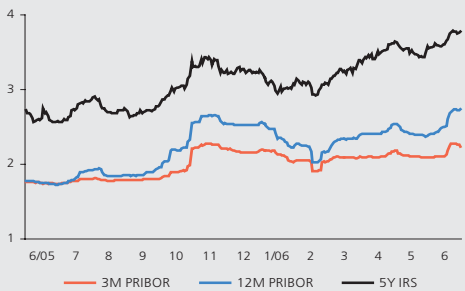


III.2.1 Interest rates

The CNB left its key rates unchanged in 2006 Q2. The 2W repo rate remained at 2%, the Lombard rate at 3% and the discount rate at 1%. Financial market interest rates were mostly rising, however. The main factor was expectations of a monetary policy tightening in the Czech Republic and a continuation of this process in the USA and the euro area. The most important economic indicator released was that of higher growth in household consumption in 2006 Q1, which market participants assessed as a signal for the CNB to raise its key rates. Inflation in May was also higher than expected.

The upward trend was interrupted in May, when rates dropped in response to the CNB Bank Board's April meeting. As expected, the rates remained unchanged at this meeting, but the message of the subsequent press conference and the minutes was more moderate than expected by the market. The fall in rates was also due to the appreciating exchange rate of the koruna, which tightened the overall monetary conditions.

CHART III.6
Market interest rates mostly rose in 2006 Q2
(percentages)



At the end of May, interest rates started rising again. In 2006 Q2, money market rates rose by 0.1–0.3 percentage point in general, while rates with longer maturities increased by as much as 0.4 percentage point depending on maturity. PRIBOR spot quotations and FRA forward quotations at the end of June 2006 indicated that the majority of the financial market expected a monetary policy tightening to occur in 2006 Q3.

The PRIBOR yield curve gradually shifted to a higher yield level, except at the shortest maturities. Its slope therefore became more positive. The spread between

[6] 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.

the 1Y PRIBOR and 2W PRIBOR was 0.52 percentage point in June. The IRS yield curve also moved upwards, but, unlike the money market curve, rates rose at all maturities. In June, the average 5Y-1Y spread was 1.05 percentage points and the 10Y-1Y spread 1.44 percentage points.

The evolution of the interest rate differential on the money market (PRIBID/CZK-LIBOR/EUR, USD) was affected by changes in key rates and movements in interbank market rates. Key rates increased in both the most important economies. The Fed continued increasing its key O/N rate (in two steps to 5.25%). The ECB raised its refinancing operations rate to 2.75%. The interest rate differential vis-à-vis euro and dollar rates was negative at all maturities.

Six auctions were held on the primary government bond market, with original maturities of 3Y–15Y and a total volume of CZK 33.5 billion. Some auctions met with lower interest from investors, and one auction was not even subscribed. This was due to an expected rise in yields on the secondary market and negative sentiment regarding Central European markets.

The evolution of interest rates on the financial market is also reflected in client interest rates. Nominal interest rates on new loans were 5.6% and rates on new time deposits 1.7% in May. Real interest rates[7] 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 May, while real rates on time deposits were -0.9%.

III.2.2 THE EXCHANGE RATE

The average exchange rate of the koruna against the euro was CZK 28.4/EUR in 2006 Q2, which represents a year-on-year appreciation of 5.8% (and a quarter-on-quarter appreciation of 0.8%). The appreciation trend which started in 2004 Q2 thus continued. This was due primarily to the favourable evolution of the economy (in particular the rapid economic growth and the further relatively positive development of the trade balance) and to the weakening of the dollar. The appreciation of the koruna continued to be moderated by a widening negative interest rate differential vis-à-vis most major world currencies. Of the Central European currencies, only the Czech koruna recorded an appreciation trend. Its appreciation occurred despite a relatively wide negative interest rate differential vis-à-vis the other currencies in the region. The June tendency towards a moderation of the appreciation pressures on the koruna was probably related to a revision of the investment outlook in emerging markets as a result of rising bond yields in the euro area and the USA, to the widening of the negative interest rate differential vis-à-vis the euro and the US dollar, and to foreign currency purchases by some major companies for payments of dividends to non-residents.

In 2006 Q2, the average exchange rate of the koruna against the dollar was CZK 22.6/USD, which represents a year-on-year appreciation of 5.6% (and a quarter-on-quarter appreciation of 5.0%). After two quarters of depreciation, the medium-term trend of year-on-year appreciation of the CZK/USD rate thus resumed. The short-term appreciation of the dollar had been generated mainly by changes in the interest rate differential against other major world currencies as a result of rising interest rates in the USA. In 2006 Q2, the effect of the rising US rates

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

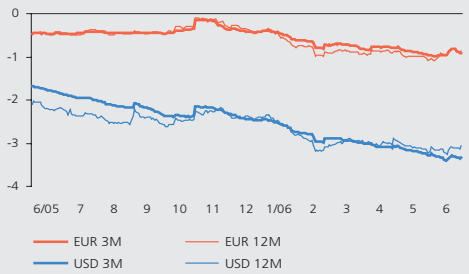


CHART III.8
Ex ante real interest rates on new loans remained flat
(percentages)

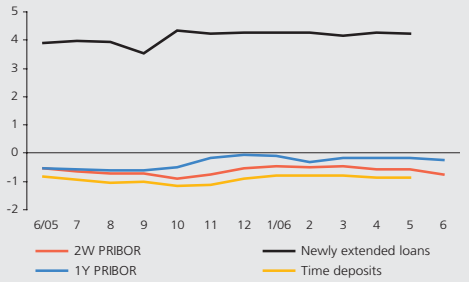
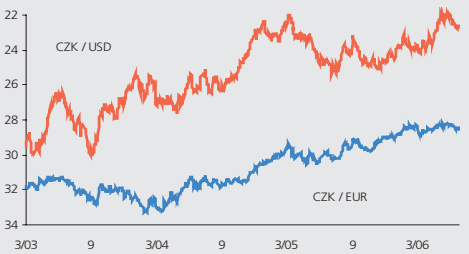
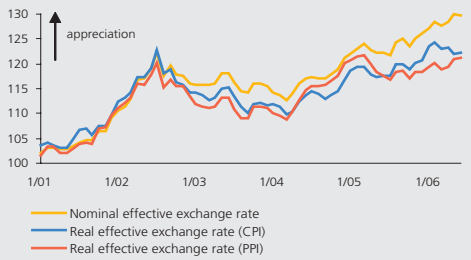


CHART III.9
The koruna appreciated against the euro and the dollar in 2006 Q2



[7] 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 2006 Q2
(year 2000 = 100)



on the dollar-euro rate and dollar-koruna rate were probably less significant, owing to the improving prospects for the euro area and the expectations of a rise in ECB interest rates. The weakening of the dollar was moreover generated by a shift in investor interest from cyclical factors (interest rate growth) to structural factors (the external imbalance of the US economy, diversification of foreign exchange reserves). The dollar's appreciation tendency in June resulted primarily from communications from Fed representatives hinting at a further rise in rates. This rise indeed occurred at the end of Q2.

The nominal effective exchange rate of the koruna appreciated by 5.7% year on year in 2006 Q2. This more marked appreciation by comparison with Q1 was mostly due to the koruna's year-on-year appreciation against the euro, the dollar and the pound. By contrast, it was moderated above all by a lower appreciation of the koruna against the zloty, the rouble and the Slovak koruna. Owing to the evolution of the koruna's nominal exchange rate, the year-on-year appreciation of the real effective exchange rate deflated by the CPI slightly accelerated as well (to 4.2%). The slowest pace of annual appreciation was recorded by the real effective rate deflated by the PPI (1.5%). However, in Q1 the real effective rate deflated by the PPI had weakened owing to much lower industrial producer price inflation in the Czech Republic than in other countries, whereas in Q2 it started strengthening again as a result of rising domestic producer price inflation.

III.3 THE BALANCE OF PAYMENTS

III.3.1 The current account

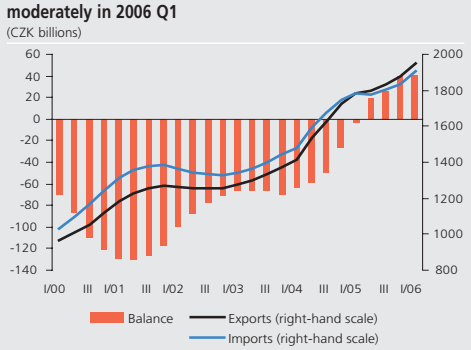
Table III.1
The current account surplus decreased significantly in 2006 Q1, due mainly to a deterioration in current transfers
(CZK billions)

	I/03	I/04	I/05	I/06
A. Current account	-6.9	-15.0	18.8	0.2
Trade balance	-4.5	1.7	26.2	25.5
Balance of services	3.2	1.8	3.5	0.8
Income balance	-15.0	-19.2	-22.7	-26.5
Current transfers	9.4	0.7	11.8	0.5
B. Capital account	0.0	0.4	1.4	2.7
C. Financial account	34.1	4.8	-9.6	-1.5
Direct investment	27.0	27.2	32.0	18.9
Portfolio investment	-32.7	25.6	-20.5	-5.5
Financial derivatives	-0.6	-0.3	1.1	-1.6
Other investment	40.5	-47.7	-22.3	-13.3
D. Errors and omissions	-14.9	16.7	-7.4	-0.8
Change in reserves (- = increase in reserves)	-12.3	-6.9	-3.2	-0.7

The current account recorded a slight surplus of CZK 0.2 billion in 2006 Q1. Since it ended almost balanced, its ratio to GDP was zero. Adjusted for reinvested earnings of non-residents, the surplus would have been higher. In year-on-year terms, the current account surplus decreased by CZK 18.6 billion. The deterioration was chiefly due to a decline in the surplus on current transfers caused by base effects related to damages paid to ČSOB by Slovakia. The income balance and the balance of services also recorded less significant deteriorations.

The trade surplus amounted to CZK 25.5 billion in 2006 Q1. At just CZK 1.3 billion, however, its year-on-year growth slackened considerably. By contrast, the annual growth in foreign trade turnover was much higher than in the previous quarter. The improvement in the trade balance was due exclusively to favourable developments in the physical volume, as export growth outpaced import growth by 5 percentage points. The price developments were unfavourable, almost entirely offsetting the positive effect of the physical volume (the negative annual change in the terms of trade increased to -4.8%).

Chart III.11
The annual moving total of the trade surplus increased only moderately in 2006 Q1
(CZK billions)



The annual trade balance improvement was mostly due to continuing favourable developments in the SITC 7 category (machinery and transport equipment), where the surplus increased by CZK 20.8 billion thanks mainly to a rise of CZK 17 billion in the surplus on road vehicles. A sizeable improvement was recorded in the surplus on SITC 8 – miscellaneous manufactured articles. The trade balance improvement was again associated with positive changes on the supply side due to the past inflow of foreign direct investment and relocation of production from advanced market economies to the Czech Republic, reflected in rapid real export growth. The main factor counteracting the growth in the overall surplus was a further widening of the deficit in the SITC 3 category (mineral fuels) of CZK 15.5 billion year on year. As the physical volume of oil and natural gas imports was broadly flat, the increase in the deficit on mineral fuels was essentially due to year-on-year growth in oil and

gas prices. A more substantial deterioration in balance was recorded in the SITC 6 category (manufactured goods classified chiefly by material), where the surplus narrowed year on year owing to high world prices of metals.

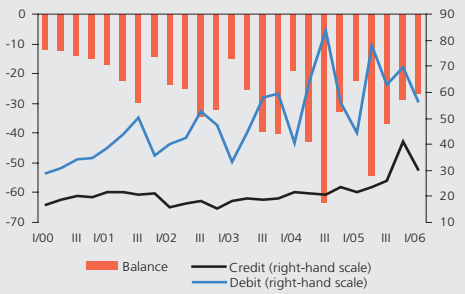
From the geographical perspective, the trade balance improvement was again due primarily to an increase in the trade surplus with the EU (of CZK 8.3 billion to CZK 86.3 billion). An improvement was recorded particularly for trade with the United Kingdom. By contrast, trade balances deteriorated with the Czech Republic's major partners, i.e. its neighbouring countries, Germany in particular. As regards other states, a deterioration was visible for trade with China and Russia, with which the Czech Republic has the biggest deficits of all (in the former case due to high imports of machinery, appliances and components, and in the latter case due mainly to fuel imports).

The balance of services ended Q1 in only a modest surplus of CZK 0.8 billion, down by CZK 2.7 billion year on year due to a decline in receipts. The trend of a year-on-year rise in the surplus on services, visible last year, thus came to a halt. The decreasing surplus was caused by less favourable developments in all three balances (transport, travel and other services). The biggest deterioration was recorded by other services, where the deficit widened by CZK 2.0 billion, primarily as a result of a more marked decline in receipts for services between affiliated enterprises and financial services.

The income deficit reached CZK 26.5 billion (a year-on-year deterioration of CZK 3.9 billion). The biggest component was an outflow of reinvested FDI earnings on the debit side. In year-on-year comparison, the deficit on direct investment income widened (to CZK 26.9 billion), as did the deficit on compensation of employees, due to faster growth in wages paid to foreigners working in the Czech Republic. The increase in the income deficit was counteracted by a widening surplus on investment income on other investment, thanks to faster growth in receipts, income on the CNB's foreign exchange reserves and interest income of commercial banks on foreign deposits.

Current transfers ended in just a modest surplus of CZK 0.5 billion, down by CZK 11.4 billion from a year earlier. Adjusted for a one-off transaction relating to damages paid to ČSOB by Slovakia in 2005 Q1, however, it would have shown a modest year-on-year improvement. Current transfers were mainly affected by the balance vis-à-vis the EU budget, which ended in a surplus of CZK 1.5 billion.

CHART III.12
The income deficit increased moderately year on year in 2006 Q1
(CZK billions)



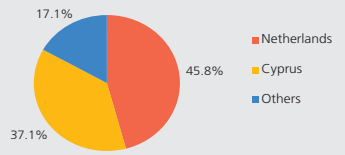
III.3.2 THE CAPITAL ACCOUNT

In Q1, the capital account recorded a surplus of CZK 2.7 billion, up slightly on a year earlier (by CZK 1.3 billion). Income from EU structural funds was the main component. An increase in the surplus on government transfers thus directly reflected higher inflow of funds from the European Regional Development Fund. Growth in the surplus on private capital transfers was mainly associated with residents' income from emission allowance trading.

III.3.3 THE FINANCIAL ACCOUNT

The financial account showed a deficit of CZK 1.5 billion, or -0.2% of GDP, in Q1 (compared to a deficit of CZK 9.6 billion in the same period of 2005). The year-on-year decline in the deficit was chiefly due to a moderation of the net portfolio investment outflow resulting from residents' generally lower interest in foreign

Chart III.13
Firms registered in the Netherlands were the largest foreign investors in the Czech Republic in 2006 Q1

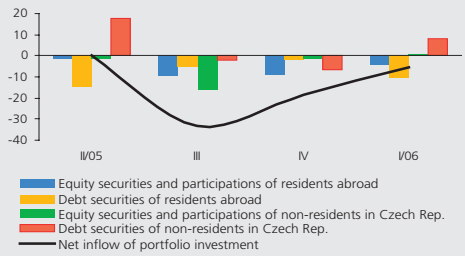


securities and also to a decrease in the other investment deficit linked with a change in flows (drawings) of short-term assets of commercial banks from abroad. The decline in the overall deficit was counteracted by a moderation of the direct investment surplus as a result of an equity reduction accounting operation executed by a non-resident.

Direct investment ended in a surplus of CZK 18.9 billion, down by CZK 13.1 billion from a year earlier. The total FDI inflow was CZK 22.7 billion, despite a year-on-year moderation. The largest item was reinvested earnings of non-residents (CZK 27.6 billion); their estimated volume increased year on year. The decline in the total inflow was a result of a fall in investment in equity capital affected, in turn, by an accounting operation that reduced the equity of a foreign-owned company in the Czech Republic. With regard to industries, the capital inflows were channelled primarily into real estate, manufacturing (particularly of motor vehicles) and trade. By territory, the biggest investors were EU countries, most notably the Netherlands and Cyprus.

Czech direct investment abroad increased year on year thanks to the rise in reinvested earnings, reaching CZK 3.8 billion. The outflow of capital was channelled mainly into wholesale and retail trade. Geographically, it went mainly to EU countries, particularly Slovakia.

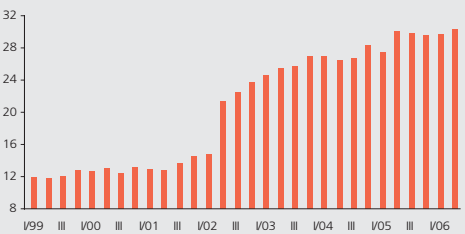
Chart III.14
The net portfolio investment outflow decreased in 2006 Q1
(CZK billions)



The net outflow of portfolio investment in 2006 Q1 was CZK 5.5 billion (compared to CZK 20.5 billion in the same period of 2005). With non-residents' demand generally only slightly lower, the year-on-year decrease in the overall deficit was affected by falling resident interest in foreign debt securities. Roughly two-thirds of the capital outflow of CZK 14.6 billion was attributable to increasing holdings of foreign bonds and one-third to a rise in foreign share holdings by residents. Although the negative interest rate differential vis-à-vis most currencies increased slightly in Q1, residents' interest in foreign debt securities decreased year on year (but increased by comparison with the previous two quarters). Whereas demand for bonds fell more significantly, interest in foreign shares decreased only slightly.

The inflow of portfolio investment from abroad was CZK 9.1 billion. Although it was virtually unchanged in year-on-year comparison, it resulted from opposite flows of equity and debt securities. The decline in equity securities held by non-residents halted in 2006 Q1 and there were even some small purchases. The increased interest in shares could be associated with the favourable financial results of domestic companies. By contrast, overall investment in debt securities by non-residents was lower than a year earlier. This decrease was, however, greatly affected by a eurobond issue of CZK 30 billion in 2005 Q1. The inflow of portfolio investment was again considerably influenced by issuance of long-term government bonds abroad (of CZK 6 billion) in 2006 Q1. Non-resident investment in Czech long-term bonds was lower, probably due to the interest rate differential between the koruna and major world currencies (amid rising euro and dollar rates).

Chart III.15
The CNB's international reserves increased in dollar terms in 2006 Q2
(USD billions)



Financial derivatives generated a CZK 1.6 billion rise in the financial account deficit. Their turnover was low compared to the other financial account items.

Other investment recorded a net capital outflow of CZK 13.3 billion (compared to CZK 22.3 billion in the same period of 2005). Amid high flows of short-term assets and liabilities, the commercial banks' position ended in a modest surplus. The overall net outflow of commercial banks' capital (of CZK 4.5 billion) was thus the result of a rise in their long-term assets abroad. At the same time, the volume of European Commission funds deposited on accounts with the CNB declined by CZK 5.6 billion. The net outflow of other investment was attributable not only to the banking sector, but also to the corporate sector thanks to an increase in export credits and other assets abroad. While drawing less credit in the form of financial

loans, this sector recorded a net outflow of funds of CZK 5.6 billion. By contrast, a net inflow of government sector funds (of CZK 2.3 billion), associated mainly with a fall in government assets due to de-blocking operations and also with an EIB loan for the development of education and financing regional projects, fostered a reduction in the net capital outflow.

The CNB's international reserves decreased by CZK 20.9 billion to CZK 681.7 billion in 2006 Q2. This was due mostly to exchange rate differences. In dollar terms, the reserves rose by USD 0.7 billion to USD 30.4 billion in the same period.

III.4 MONETARY DEVELOPMENTS

Annual money supply growth accelerated in 2006 Q1 in line with GDP growth. The low level of nominal interest rates continued to support a pick-up in the most liquid component of the money supply. The favourable financing conditions were reflected in a further rise in growth in lending to corporations and households. The buoyant growth in long-term loans to corporations was in line with the positive expectations regarding fixed investment. In 2005, debt increased in high-income households and was accompanied by saving.

III.4.1 Money

Annual M2 growth picked up in 2006 Q1. This trend continued into April, but in May, M2 growth slowed to 7.9% (see Chart III.16). The annual rate of growth of M2 adjusted for exchange rate movements and other non-transaction effects followed a similar pattern and was 8.7% in May. The relatively high growth rate of M2 visible since the end of last year was in line with GDP growth (see Chart III.17).

Turning to the components of M2, the main contribution to the M2 growth came from M1 (see Table III.2). Annual M1 growth was 15.1% in May. Growth in overnight deposits by non-financial corporations and households increased. By contrast, demand by economic agents for currency slackened slightly. The rising contribution of M1 to M2 growth confirms the impact of the low interest rate level, which implies low opportunity costs of holding money. Annual growth in quasi money increased in Q1, then decreased in May to a negative value (-0.1%). This was reflected in deposits with agreed maturity, particularly in the case of non-financial corporations. By contrast, growth in deposits redeemable at notice continued rising. Within deposits redeemable at notice, the fastest growing were household deposits redeemable at notice of up to three months. Their growth rate has been rising since 2004 owing to better interest rates compared to other deposit products. However, these deposits account for only about one-fifth of the household deposits included in M2. Within quasi money, there was a substantial rise in the rate of growth of repos in Q1, particularly in the case of non-monetary financial institutions. In April and May, this trend saw a partial correction. The share of repo operations in M2 remained very low.

Turning to the sector structure of M2 deposits, year-on-year growth in household deposits gradually increased in the period under review. The rate of growth of deposits by non-financial corporations picked up in Q1, then slowed in April and May (see Chart III.18). The higher growth in deposits by non-financial corporations contributed to the increase in M2 growth in Q1. This was linked with an improvement in pre-tax profits. As regards currency, koruna deposits recorded lower growth in April and May, whereas foreign currency deposits continued to accelerate. The higher rise in foreign currency deposits visible since the end of 2005 is associated with the creation of temporary free funds from export activities and

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

Chart III.17
The pick-up in M2 growth in 2006 Q1 was in line with GDP growth
(annual percentage changes)

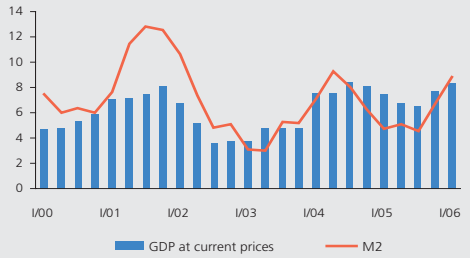


Table III.2
M1 accounted for much of the money growth
(quarterly averages and end-of-month stocks; annual percentage changes)

	III/05	IV/05	1/06	4/06	5/06	Outstanding amount as % of M2 5/06
M1	6.4	11.1	13.4	15.1	15.1	56.2
Currency in circulation	8.3	10.3	10.0	10.9	9.9	13.2
Overnight deposits	5.7	11.4	14.5	16.5	16.8	43.0
M2-M1 (quasi money)	2.6	1.7	3.8	2.6	-0.1	43.8
Deposits with agreed maturity	0.7	-1.2	-0.1	-1.5	-5.1	32.0
Deposits redeemable at notice	10.5	11.5	12.7	14.1	14.6	11.0
Repurchase agreements	-9.9	11.6	123.0	65.9	55.3	0.8
M2	4.5	6.6	8.8	9.0	7.9	100.0

Chart III.18
Growth in deposits by non-financial corporations fell in April and May after rising in Q1
(annual percentage changes)

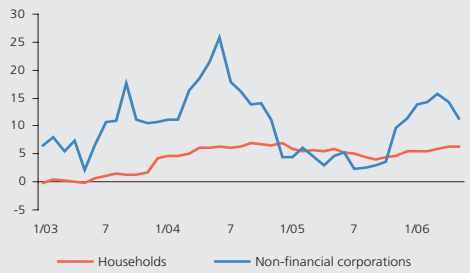


Table III.3
Growth in lending to corporations and households increased further
(quarterly averages and end-of-month stocks; annual percentage changes)

	III/05	IV/05	1/06	4/06	5/06	Outstanding amount as % of total loans 5/06
Non-financial corporations	12.9	12.3	14.3	15.4	16.7	49.5
Loans up to 1 year	12.9	10.1	11.9	13.0	17.2	19.8
Loans over 1 year and up to 5 years	14.0	13.8	10.1	9.0	5.9	11.7
Loans over 5 years	11.9	13.9	20.4	23.0	24.4	18.0
Households	33.2	33.0	33.4	32.7	32.5	39.6
Consumer credit	32.1	31.5	32.7	30.0	28.0	8.3
Loans for house purchase	35.9	35.0	35.0	34.5	34.3	27.0
Other loans	20.6	24.2	25.3	27.4	30.4	4.3
Non-monetary financial institutions	6.6	5.2	6.2	6.7	7.1	10.9
Total loans	19.0	19.1	20.1	20.5	21.3	100.0

Chart III.19
Corporations drew mainly on domestic loans
(net annual flows; CZK billions)

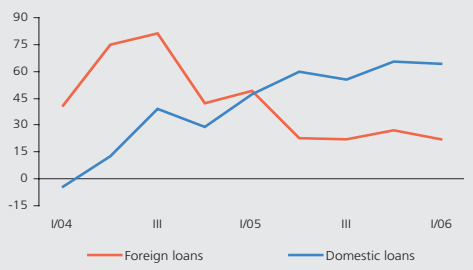


Chart III.20
Lending to households remained buoyant
(annual percentage changes)

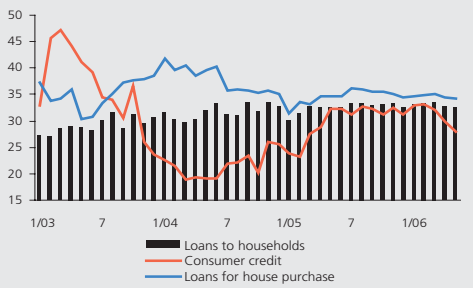
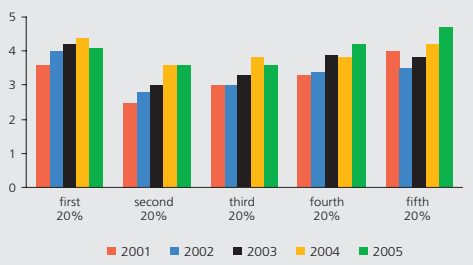


Chart III.21
The debt burden of higher-income households increased in 2005
(ratio of loan repayments and instalments to net money income; annual per capita averages in percentages)



with the uncertainty surrounding the exchange rate going forward. Corporate demand for foreign currency deposits is still being partly supported by slightly higher interest rates compared to koruna deposits. However, the share of foreign currency deposits in total corporate deposits remains relatively low (at about one-fifth).

As regards the counterparts of M2, the pick-up in annual M2 growth (adjusted for exchange rate and other non-transaction effects) was affected by a further increase in growth in loans to corporations and households to 22.1%. A slower decline in the negative annual growth in net credit to the government to -54.8% also had a positive effect. In addition to a reduction in net credit to the CCA, this reflected a pick-up in credit to central government amid a modest rise in the growth of government deposits. The annual rate of growth of other net items decreased further, to 10.4%[8], mainly because of slowing growth in MFI capital and reserves and lower resident interest in investing in MFI debt securities with maturities of over two years. Conversely, M2 growth was corrected by a decrease in the annual rate of growth of net foreign assets, to 11.2%, associated above all with slowing growth in MFI assets abroad.

III.4.2 Credit

Annual growth in loans to corporations and households accelerated in Q1. This trend continued into April and May, with the rate of growth reaching 21.3%[9] in May (see Table III.3). The rapid growth in lending continued to be supported by the low level of interest rates, stronger supply of MFI loans and favourable expectations of economic growth.

Loans to non-financial corporations increased gradually over the period under review, their annual rate of growth reaching 16.7% in May. As regards the breakdown by maturity, growth in short-term and long-term loans picked up pace. The higher short-term borrowing was in line with the increase in corporations' operating capital. Long-term loans were supported by faster growth in fixed investment and expectations of further moderate growth in the same. Turning to the sector structure, loans to the manufacturing sector, the machinery and equipment rental sector, the electricity, gas and water supply industry and the construction industry contributed to the pick-up in loans to corporations. The contributions of services, i.e. trade, sales, maintenance and repairs, and transport and storage were significant, despite being flat or falling. As regards currency structure, loans in foreign currencies rose, although to a lesser extent than koruna loans. However, the share of foreign currency loans in total loans to corporations was below one-fifth. Net borrowing by corporations from abroad declined in Q1, owing to the higher level of interest rates in the euro area than in the Czech Republic (see Chart III.19). Despite the continuing growth in lending, the share of external funds (including bond issues, intercompany debt, etc.) in the total liabilities of non-financial corporations with 100 employees or more decreased moderately to 46%.

Annual growth in loans to households increased in Q1 and then slowed in April and May to 32.5% (see Chart III.20). Housing loans, especially mortgage loans, still accounted for the majority of the increase in loans. This was due to the low level of interest rates on housing loans, the supply of MFI loans and the gradual increase in households' gross disposable income, which eased the credit constraints on

8 The change in other net items corresponds to the change in money supply with an opposite sign, since these are liabilities in the MFI consolidated balance sheet.

9 The contributions of loans to households and non-financial corporations to the growth in lending increased in the period under review, although loans to households still accounted for more than one-half of the total.

households. However, the rate of growth of housing loans did not increase. Following a pick-up in Q1, growth in consumer credit[10] slowed in April and May. The volume of loans from other financial intermediaries remained almost unchanged in Q1; 98% of these loans were used to finance consumption expenditure.[11] As a result of the buoyant growth in loans to households, the ratio of household debt to GDP increased by 0.3 percentage point to 17.7% in Q1.[12] This ratio remains low by comparison with the euro area.

Recent data from the household budget statistics on the breakdown of loans by household income category show that, as in previous years (see the box *Implications of household debt for consumption* in the April 2006 Inflation Report), higher-income households recorded the highest absolute volume of newly received loans and hire purchases (the two highest-income categories of households accounted for 62% of loans received by households). The debt burden was still much higher in low-income and high-income households than in medium-income households (see Chart III.21). Unlike in 2001–2004, it grew in the two highest-income categories in 2005, while it was flat or falling in the low-income and medium-income category. Households with the highest income created savings. The ratio of savings deposits to net money income was 11.8% for the highest-income households and 3.8% for the lowest-income households.

The overall interest rate on new loans to non-financial corporations and households remained roughly at 5.6%. The spread between this interest rate and the 1Y PRIBOR (i.e. the rate from which the rates on most new loans are derived) was also broadly unchanged at 3.1 percentage points. From the longer-term perspective, this spread has declined since mid-2005, i.e. the conditions for providing new loans have become easier. Short-term rates were mostly flat or falling. Since the beginning of this year, long-term rates have risen slightly in the cases of housing loans (see Chart III.23) and loans to non-financial corporations of over CZK 30 million (see Chart III.24). This is consistent with movements in yields on the capital market.

III.5 DEMAND AND OUTPUT

Economic growth rose further in 2006 Q1, reaching its highest ever level in the history of the Czech Republic. Compared to the previous quarter, annual real GDP growth picked up by 0.5 percentage point to 7.4%. According to the CNB's estimates, the output of the economy exceeded the potential, non-inflation accelerating level of output in 2006 Q1.

On the demand side, all expenditure components except government demand contributed to the buoyant GDP growth. The main factor underlying the GDP growth in 2006 Q1 was a sizeable increase in gross capital formation, driven by fixed investment and inventories. The continuing investment growth was in line with the current phase of the business cycle and was supported in large measure by foreign capital inflow and easy monetary policy. The contribution of net exports was less

CHART III.22
The interest rate on new consumer credit decreased somewhat
(percentages)

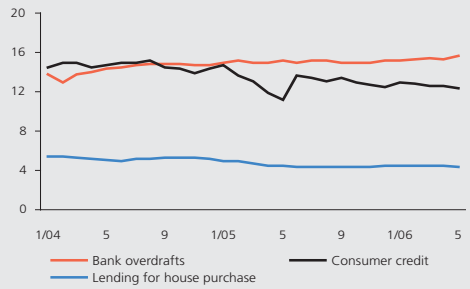


CHART III.23
Long-term interest rates on new housing loans increased slightly
(percentages)

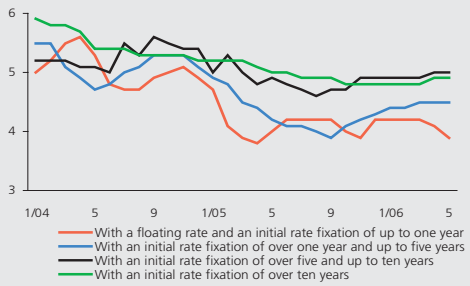


CHART III.24
The interest rate on new loans of over CZK 30 million to non-financial corporations increased only slightly, despite the rise in long-term rates
(percentages)

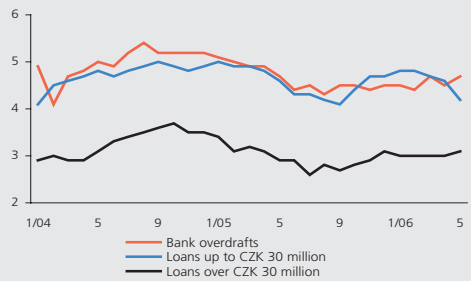


CHART III.25
Economic growth rose to 7.4% in 2006 Q1
(annual percentage changes)

10 Traditional consumer credit dominated the consumption loan structure (accounting for 78%), while the shares of bank overdrafts and card credit were less significant (15% and 7% respectively). However, these shares have increased over the past few years, a trend connected with the supply of these types of credit by MFIs.

11 The volume of loans granted by other financial intermediaries (OFIs) was CZK 97.8 billion in Q1 (compared to MFI loans to households of CZK 456.6 billion, of which consumer credit was CZK 95.2 billion). As regards the structure of OFI loans, hire-purchase companies accounted for CZK 48 billion and financial leasing companies for CZK 49.8 billion.

12 The ratio of MFI loans to GDP rose by 0.4 percentage point to 14.4% in Q1, while the analogous ratio for OFI loans fell by 0.1 percentage point to 3.3%.

significant in Q1 than in 2005. Although the lead of export growth over import growth decreased, real exports rose very quickly, testifying to the continuing high export performance of the Czech economy. Consumer demand increased and contributed to the GDP growth approximately to the same extent as the external sector.

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

III.5.1 Domestic demand

Compared to the previous quarter, growth in final consumption expenditure increased by 0.6 percentage point to 2% in 2006 Q1. This increase was due almost entirely to a rise in households' consumption expenditure (of 3.4% year on year), as government expenditure again recorded an annual decline and the rise in expenditure by non-profit institutions was insignificant. Expenditure on gross fixed capital formation grew much faster than household consumption (by 7.1%), but its contribution to the total increase in domestic demand was only slightly higher. Additions to inventories also rose significantly in 2006 Q1, fostering a rise of almost 17% in gross fixed capital formation.

Table III.4
Final consumption expenditure rose in 2006 Q1
(annual percentage changes; CZK billions)

	2005 Q1	2005 Q2	2005 Q3	2005 Q4	2006 Q1
Gross domestic product	5.4	6.1	5.9	6.9	7.4
Final consumption expenditure	0.8	1.9	3.1	1.4	2.0
of which:					
Household consumption	1.8	2.5	2.7	2.4	3.4
Government consumption	-1.4	0.8	4.5	-1.0	-1.0
Non-profit institutions serving households	1.0	-1.5	-4.1	4.6	0.6
Gross capital formation[a)]	1.9	0.6	1.9	7.3	16.7
Gross fixed capital formation	2.3	3.8	3.8	4.4	7.1
Net exports of goods and services					
(CZK billions)	-2.3	-7.6	-16.1	-19.2	6.4
Imports of goods and services	10.1	-0.3	6.3	4.8	15.3
Exports of goods and services	16.5	5.9	10.9	10.1	17.0

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

Chart III.26
Growth in consumer demand picked up in 2006 Q1
(annual percentage changes)

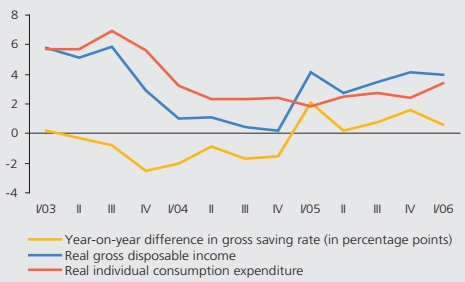
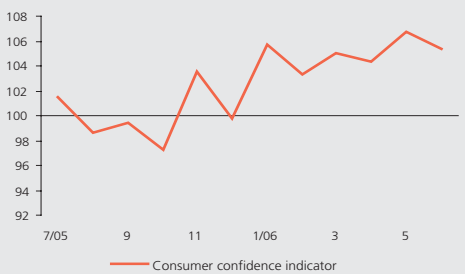


Chart III.27
The consumer confidence indicator reached historical highs in 2006 Q1 and Q2
(basic index)



Consumer demand

At 3.4%, annual growth in household final consumption expenditure in 2006 Q1 was up by 1 percentage point on the previous quarter. This suggested a continuing gradual strengthening of consumer demand growth since 2005 Q2. According to a CZSO survey, the consumer confidence of households remained high at the beginning of the year and increased further in Q2.

Growth in the nominal gross disposable income of the household sector rose to 6.9% year on year in 2006 Q1, the highest figure for several years. Owing to inflation[13], however, real disposable income increased less (by 4%), rising at roughly the same pace as at the end of 2005. However, household expenditure growth increased year on year in 2006 Q1 (to 3.4%). Given the unchanged growth rate of real disposable income, this meant that households continued to increase their savings, albeit at a slower pace than at the end of 2005 (see Chart III.26). As in previous quarters, given the relatively low interest rates, households also borrowed to finance their consumption expenditure. According to statistics for 2006 Q1, the rate of growth of borrowing remained high, increasing slightly compared to 2005 Q4.

Nevertheless, gross disposable income was still the main source of financing of the increased household final consumption expenditure in 2006 Q1. Its annual increase was fostered mainly by continuing relatively stable growth in wages and salaries (of 6.8% year on year), which account for more than 40% of households' current income. The contribution from social benefits[14], whose year-on-year growth exceeded 7%, was also significant. They rose most significantly in the social security payments and pensions category.

Investment demand

The evolution of investment demand in 2006 Q1 suggested a continuation of the relatively strong growth trend visible since 2005 Q2. At 24.9%, the ratio of

13 Measured by the household consumption deflator.
14 i.e. social benefits other than social transfers in kind.

investment to GDP remained relatively high. As in the previous period, technological investment had the biggest impact on the further pick-up in annual growth in gross fixed capital formation to 7.1% in 2006 Q1.[15] Most of this investment, which accounts for around 60% of total investment, was channelled into machinery and equipment (see Chart III.29). By contrast, construction investment declined overall in year-on-year terms in 2006 Q1, following a moderate increase at the end of 2005. Underlying this change were developments in the category of non-residential buildings, whose more pronounced annual decline at the beginning of the year (of 4.3%) was only partly offset by a recovery in investment in dwellings.

The persisting rapid growth in technological investment indicated continuing strong investment demand by non-financial corporations, which account for roughly two-thirds of total investment. This was also suggested by other partial indicators[16] of the investment activity of large non-financial corporations, whose share in the total assets of the non-financial corporations sector is roughly 60%. This included, above all, a year-on-year rise of more than 20% in the value of tangible fixed assets acquired by large non-financial corporations at current prices, particularly in the categories of machinery and equipment and transport equipment. These developments were supported not only by the continuing inflow of foreign direct investment, but also by the strengthening investment activity of domestic corporations. This was visible in assets acquired by domestic private and public corporations, which more than doubled.

Investment by households and government rose at the beginning of 2006, but their contribution to the increase in investment was not so significant compared to that of non-financial corporations. The growing investment demand of the government sector was indicated by a pick-up in capital expenditure in the state budget, although this was due partly to base effects. In the household sector, growth in demand for housing investment accelerated (by 8% year on year) in 2006 Q1. A moderate increase in the growth rate of dwellings under construction and renewed growth in housing starts indicated that construction companies and developers expect households to continue spending more on housing in the period to come. This expectation is probably based on the continuing favourable conditions for borrowing for housing, the expected increase in VAT on housing construction as from 1 January 2008 and expected drawing of the recently approved government housing support for young married couples.

Chart III.28
The upward trend in investment demand growth continued into 2006 Q1
(annual percentage changes; constant prices)

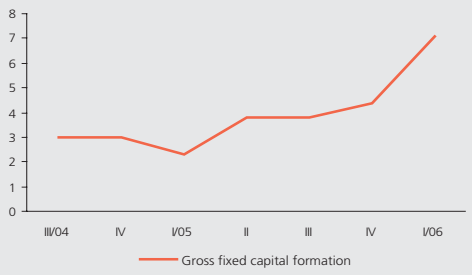
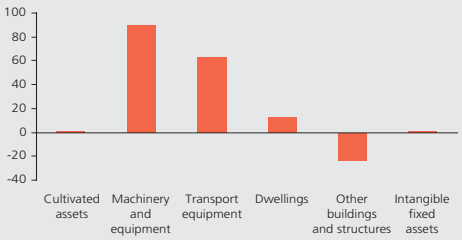


Chart III.29
Rapidly growing technological investment was the biggest contributor to the generally buoyant investment growth in 2006 Q1
(annual changes in CZK billions; constant prices)

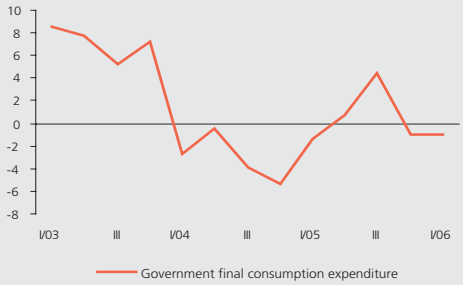


Government demand

In 2006 Q1, general government expenditure on final consumption confirmed a return to a downward trend, declining for the second consecutive quarter (by 1%) following a short-lived extraordinary increase. At current prices, final government consumption rose by 4.4%. The assessment of government demand is based on an analysis of the state budget, which represents a key component of the government sector's performance. In 2006 Q1, the state budget ended in a surplus of CZK 15.7 billion, an improvement of CZK 7.4 billion compared to the same period last year.[17] This result was due mainly to a larger year-on-year increase in state budget revenue (14.1%) than in budget expenditure (10.9%).

The relatively large increase in total state budget revenue was fostered by higher tax and non-tax income. However, the individual types of tax revenues showed very

Chart III.30
Government final consumption expenditure continued to record a modest decline in 2006 Q1
(annual percentage changes)



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 total investment is based on partial indicators.

17 In 2005 Q1, the state budget recorded a surplus of CZK 8.3 billion.

mixed rates of growth. As regards indirect taxes, VAT collection rose significantly (by 27.7%), whereas growth in revenues from excise duties was much lower at 5.8%. Turning to direct taxes, corporate income tax revenues continued to grow rapidly in 2006 Q1. Conversely, the increase in personal income tax collection was relatively modest (2.4%), mainly as a result of a reduction in the tax rates as from 1 January 2006. The year-on-year growth in total revenues was also due to a sizeable increase in funds transferred to the state budget from last year's reserves. The relatively rapid rise in state budget expenditure in 2006 Q1 was due chiefly to extraordinary transfers to social security and health insurance funds in January 2006.[18] However, these expenditure items do not directly affect government demand. By contrast, government demand is directly influenced by growth in public employee wage expenditure, which was flat year on year in 2006 Q1 at the previous quarter's level (4.6%). To sum up, the most recent budget statistics suggest that government expenditure did not contribute to the increase in demand in the Czech economy in 2006 Q1.

III.5.2 Net external demand

Chart III.31
The gradual year-on-year decline in the net export deficit turned into a surplus in 2006 Q1
(CZK billions; constant 2000 prices)

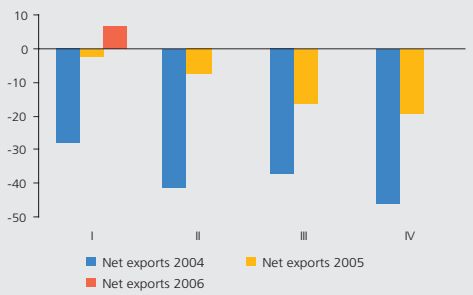
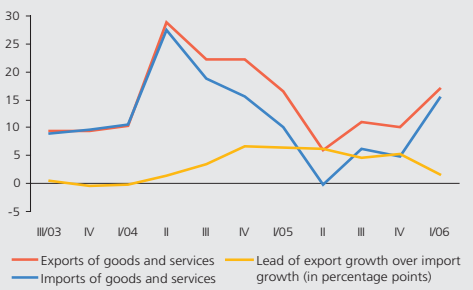


Chart III.32
Faster export growth than import growth contributed to the positive net export figures
(annual percentage changes; constant prices)



The evolution of net external demand in 2006 Q1 confirmed the favourable trends visible in previous quarters. The gradual decrease in negative net exports over the previous six quarters resulted in the first-ever surplus (of CZK 6.4 billion) since the start of the revised time series in 1996. This was due mainly to the continuing robust export performance of the Czech economy, reflected in faster growth in exports than imports. Consequently, the physical volume of exports exceeded that of imports in 2006 Q1 (see Chart III.31).

This favourable result was achieved thanks to the total foreign trade turnover, which almost doubled, and export growth, which rose by nearly 7 percentage points compared to the previous quarter, to 17%. However, import growth increased as well, in fact even more so than export growth (rising by 10.5 percentage points to 15.3%). As a result, the lead of export growth over import growth decreased to 1.7 percentage points and the positive contribution of net exports to GDP growth fell to 1.4 percentage points. Nonetheless, the annual improvement in net exports was almost CZK 9 billion in absolute terms.

As in the previous six quarters, the continuing favourable evolution of net exports at the beginning of 2006 was due largely to an improving trade balance, whose surplus rose by CZK 13.6 billion. This result was aided by persisting rapid annual growth in goods exports, which accelerated to almost 20% in Q1. These developments were chiefly a result of the continuing launching of export-oriented production facilities in the car industry, further transfers of production from advanced market economies to the Czech Republic and increased external demand. The growth in positive net exports was counteracted by increased growth in goods imports (17.1%), connected with the stronger growth in domestic demand and the high import intensity of Czech exports. As regards the import structure, imports for investment rose fastest, reflecting the rapid growth in domestic demand for technological investment.

The deficit on the services account, which increased moderately by CZK 2.8 billion, continued to act against the improvement in the overall balance of net exports. Overall, the evolution of the services balance suggested that, in contrast to industry, the inflow of foreign direct investment into services had yet to affect the services balance to any great extent.

[18] An advance payment to Všeobecná zdravotní pojišťovna of CZK 3 billion.

III.5.3 Output

On the supply side of the economy, the ongoing buoyant economic growth continued to be supported at the beginning of 2006 chiefly by dynamic growth in manufacturing output and rapid growth in some segments of services. Manufacturing made the biggest contribution to the 7.8% annual growth in gross value added[19] in 2006 Q1. In the services sector, trade, commercial services[20] and financial intermediation were the biggest contributors to the growth in value added. Overall, most sectors of the economy contributed to the economic growth. Value added fell in year-on-year terms only in construction, transport and some services that are not major contributors to GDP.

The fastest gross value added growth was again recorded in manufacturing. The continuing increase in its annual growth rate resulted in extraordinary growth of 18.5%, whereas gross value added in other industrial sectors rose more slowly than in the previous quarter. A further marked slowdown in value added growth was recorded especially in electricity, gas and water supply (to 3.3%), while value added in mining and quarrying was flat year on year. Under these circumstances, the share of manufacturing in total gross value added in industry remained above 80%. The generally very fast increase in gross value added in industry was achieved amid a rise in industrial production of 15.4%, fostered by favourable orders, higher employment and rapid productivity growth. These results were in line with the CZSO's business confidence indicator, which suggested positive perceptions of the present and future economic situation in industry.

The main factors underlying the continuing favourable evolution of industrial production were structural changes, supported largely by foreign capital, and a sizeable increase in demand in some sectors. The rapid growth of industrial production was also partly due to a higher number of working days (two days more). The effect of new production facilities, launched with the support of foreign capital and largely export-oriented, was particularly visible in the manufacture of transport equipment[21] and in the electrical engineering industry, where year-on-year production growth reached extraordinary figures of over 30%. The higher demand was reflected in a recovery in energy engineering production and also in the manufacture of wood and wood products thanks to a sharp upswing in external demand. Overall, the export activities of the business sector remained a significant factor underlying industrial production growth. This was reflected in a large increase in sales from direct exports (of 16.3% in real terms) and a large share thereof in total sales in industry (48.7%). In some sectors, annual export growth was as high as 30%.[22]

In services, trade was the biggest contributor to economic growth. Gross value added in trade rose by 18.2% year on year and the absolute increase in trade was by far the largest in the services sector. As in previous quarters, business services and real estate services were important contributors to the value added growth (7.1% year on year). Value added in financial intermediation and insurance rose even faster (by 12.1%), but the contribution of this sector to economic growth was lower. As regards other services, transport saw a major change, with the previous growth recorded throughout 2005 turning into a year-on-year decline of 2.2%. Gross value added in construction also decreased year on year in 2006 Q1. This can be attributed to adverse weather conditions and a halt in the growth in demand for construction investment.

Chart III.33
Manufacturing was the biggest contributor to GDP growth
(contributions in percentage points; constant 2000 prices; selected branches)

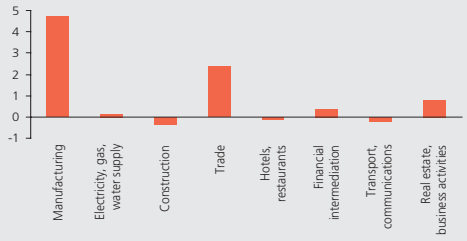


Chart III.34
The high growth in industrial production was achieved amid rapid productivity growth
(annual percentage changes; constant prices)

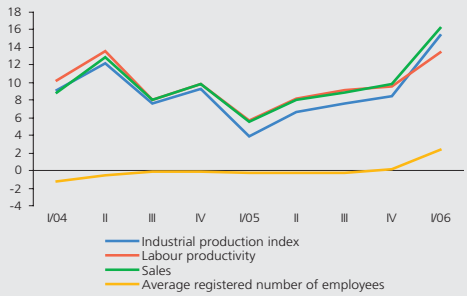


Chart III.35
The buoyant growth in industrial production was supported by fast growth in orders
(annual percentage changes; current prices)

[19] At basic prices.

[20] Real estate, business services, research and development.

[21] In 2006 Q1, manufacture of transport equipment accounted for 6.8 percentage points of the rise in industrial production of 15.4%.

[22] The largest increases in exports in 2006 Q1 were recorded in the manufacture of wood and wood products (34.5% excluding furniture), electricity, gas and water supply (28.5%), manufacture and repair of machinery and equipment (27.5%) and manufacture of transport equipment (27.3%).

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

Table III.5
Profit generation increased significantly year on year in 2006 Q1
(CZK billions; percentages)

	Q1		Annual changes	
	2006	2005	CZK billions	%
Total income	1,262,898	1,112,234	150,664	13.5
Output without profit margin	887,406	772,869	114,537	14.8
Total expenses	1,181,322	1,049,727	131,595	12.5
Cost of sales	662,603	569,442	93,161	16.4
Depreciation	53,275	49,485	3,790	7.7
Personel costs	127,846	116,061	11,785	10.2
Book value added	265,670	239,045	26,625	11.1
Net operating surplus	43,682	37,881	5,801	15.3
Pre-tax profit	81,576	62,507	19,069	30.5

Table III.6
The higher material cost-output ratio was offset by a lower personnel cost-output ratio and lower write-offs
(percentages; annual changes in percentage points)

	2006 Q1 %		Change in perc. points against 2005 Q1	
	Organisations, total	Industry	Organisations, total	Industry
Profit-expenses ratio	6.9	9.3	0.9	1.0
Profit-equity ratio	3.7	5.0	0.5	0.6
Profit-sales ratio	7.0	9.3	0.9	0.8
Assets turnover ratio	28.0	28.8	0.6	1.4
Leverage	185.3	186.6	-3.7	-2.6
Material cost-output ratio	71.4	74.8	1.0	1.0
Personnel cost-output ratio	14.4	10.2	-0.6	-0.6
Ratio of personnel costs to value added	48.1	40.3	-0.5	-0.8
	CZK thousands per month		Annual percentage changes	
Book value added per employee	56.3	66.5	8.5	9.4

The financial results of large non-financial corporations[24] reveal a pronounced year-on-year improvement in pre-tax profit in 2006 Q1 (of 30.5%). This large increase in overall profit was aided by a 15% rise in profit from core activities (known as the operating surplus) and a sharp increase in profit from non-core activities. As in the previous quarter, the favourable profit generation was achieved amid buoyant annual growth in volume indicators, an improvement in the key financial ratios and more efficient capital utilisation. This is illustrated by the almost 15% year-on-year growth in output (without the business margin), a roughly equal rise in sales of own products, an increase in book value added of 11.1% and a rise in return on equity. This historically above-average financial performance of large corporations was in line with the overall results of the Czech economy in 2006 Q1.

As in 2005, however, some corporations had to face the problem of rapidly rising expenses on imported energy-producing materials and domestic electricity at the beginning of 2006. Moreover, the prices of some other inputs of both domestic and foreign origin were mostly recording, for the time being, a moderate upturn in growth or a slowing year-on-year decline. In addition, the terms of trade declined year on year in some sectors. Under these circumstances, cost of sales rose 1.6 percentage points faster than output in Q1. Corporations partly compensated for the higher cost of sales by slower growth in personnel costs and write-offs. The reduction in the wage cost-output ratio was aided significantly by buoyant productivity growth in most sectors, accompanied by much smaller wage increases, especially in industry. This reflected, *inter alia*, the employment of workers with lower wage demands (see section III.6 *The labour market*).

Although corporations continued to operate in a strongly competitive environment, the gradual renewal in price growth in some sectors suggested that, given the favourable demand climate, corporations probably reflected part of their higher input costs in their prices (see section III.7.2 *Producer prices*). This fact probably also contributed to the more pronounced increase in profit margins[25] in the monitored corporations.

The broadly positive development of the financial performance of large non-financial corporations in 2006 Q1 was also characterised by a rise in the profit-equity ratio (by 0.5 percentage point year on year to 3.7%), due chiefly to an improvement in the profit-sales ratio. The asset turnover ratio and total assets increased as well. Under total liabilities, corporate equity rose faster. By contrast, leverage[26] recorded a decrease.

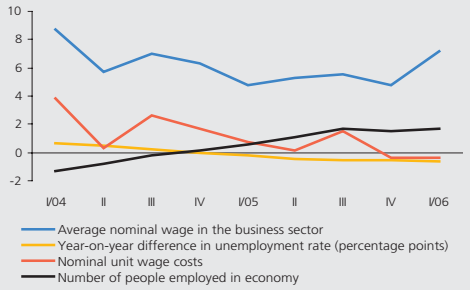
In terms of ownership structure, the financial performance of large non-financial corporations continued to show mixed trends, especially within individual sectors. All sectors from the point of view of ownership recorded large annual increases in profit. Profit generation grew fastest in public corporations (by 58.4%), whose results were strongly affected by the electricity, gas and water supply industry. More than one-half of the sectors contributed to the overall rise in profit generation in large non-financial corporations. Profit generation fell in one-fifth of the sectors and the remaining sectors posted a loss (construction, hotels and restaurants, agriculture, etc.).

23 Assessment based on figures for non-financial corporations with 100 employees or more.
24 These account for roughly 50% of the total assets and liabilities of the non-financial corporations sector and an estimated two-thirds of value added in this sector.
25 i.e. the profit-sales ratio.
26 Leverage = total capital / equity capital

III.6 THE LABOUR MARKET

The continuing employment growth in 2006 Q1 was consistent with the current phase of buoyant economic growth and foreign direct investment and related production. Increasing employment in the secondary and tertiary sectors continued to help reduce unemployment. However, the decline in unemployment was still inconsistent with employment growth in 2006 Q1. This fact suggested that labour demand had also been partly met outside the labour office register. One of its sources were foreign workers, whose growth stabilised at a noticeably lower level than a year earlier. A larger decrease in unemployment was still being prevented by the professional and skills structure of the unemployed, which was fostering persisting high long-term unemployment. Although average wage growth picked up noticeably (partly due to a higher number of working days), the wage cost-output ratio in the national economy remained almost unchanged compared to the previous quarter, owing to faster GDP growth. With nominal unit wage costs declining slightly, no inflationary pressures were generated in Q1, owing to the unbalanced developments in the relationship between wage and productivity variables.

CHART III.36
The buoyant economic growth was accompanied by rising employment
(annual percentage changes; percentage points)



III.6.1 Employment and unemployment

The data on employment in 2006 Q1 confirmed increasing labour demand amid buoyant economic growth. According to LFS figures, annual growth in the number of employed people picked up again slightly, rising by 0.2 percentage point to 1.7% compared to 2005 Q4. The structural trends in employment remained very mixed. At the start of 2006, employment again increased only in the employees category (by 2.2%), while the number of entrepreneurs continued to decline. However, their annual decrease slowed noticeably in Q1, amounting to 1%. As mentioned in previous issues of the Inflation Report, this was probably due to an improving supply of steady employment opportunities and strong competition from large retail units. According to CZSO statistics, the largest fall in the number of entrepreneurs was recorded in retail and wholesale trade, although this was partly offset by an increasing number of entrepreneurs in real estate and other business activities.

With regard to sectors, employment continued to grow in the secondary and tertiary sectors, which remained the main sources of the buoyant economic growth in 2006 Q1. Increasing employment was recorded mainly in industry, clearly reflecting foreign direct investment and related production and activities (the largest increases in employment were recorded in the categories of treatment and coating of metals and manufacture of parts and accessories for motor vehicles). As regards market services, the largest increases in employment were recorded for real estate, renting and business activities[27], where rapid growth in value added in recent quarters suggested continuing development of activities in this area. In public services there was an increase in employment in education. As in previous quarters, the rapid economic growth was not accompanied by increasing employment in all sectors. On the contrary, a number of sectors showed a decline in employment as a result of changing demand and strong competition exerting downward pressures on costs (agriculture, mining and quarrying, transport, financial intermediation, etc.). Overall, the services sector still dominated the employment structure (56.3%), although the share of people employed in the secondary sector also remained significant (40%).

CHART III.37
Employment rose only in the employees category, but the decline in the number of entrepreneurs slowed
(annual percentage changes)

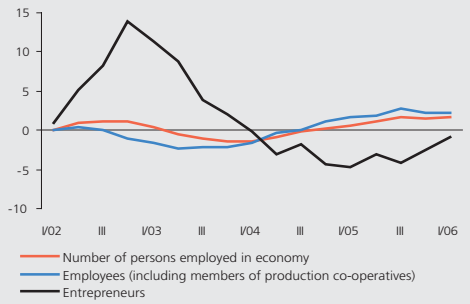
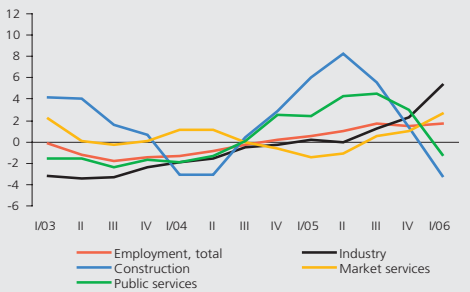


CHART III.38
Employment increased mainly in industry and market services
(annual percentage changes; source: LFS)



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

Chart III.39
The higher demand for labour started to pass through more into registered unemployment
(seasonally adjusted numbers in thousands)

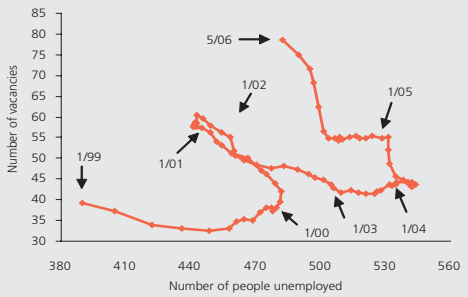
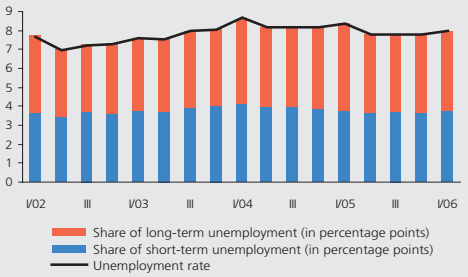


Chart III.40
Underlying the still high unemployment rate was high long-term unemployment
(percentages; source: LFS)



The creation of vacancies, which is one of the indicators of the changing situation on the labour market, also indicated increasing labour demand in the economy. The number of vacancies has been rising considerably since the start of 2006. According to the latest data for May, it was up by 24,000 on the same period a year earlier. However, this high growth only partly indicated a rise in labour demand, as particularly in Q1 the number of vacancies was also affected by new penalties imposed on employers who fail to report vacancies to labour offices.[28] This hypothesis of a changing situation on the labour market is supported by the Beveridge curve (see Chart III.39), according to which the higher labour demand also began to show up more strongly in registered unemployment in April and May. In Q1, the registered unemployment rate decreased by 0.6 percentage point year on year to 8%, and according to the latest figures the decline increased somewhat in May (by 0.7 percentage point to 7.9%). However, the seasonally adjusted registered unemployment rate continued to decline, mainly due to a higher number of unemployed people excluded from the labour office register as a result of penalties.

Although registered unemployment decreased significantly, the annual decline in the number of unemployed persons still remained below the growth in employment according to the LFS.[29] This imbalance suggests that the increased labour demand continued to be met to some extent outside the labour office register. This observation is also supported by an almost unchanging number of economically inactive persons amid increasing employment. According to the MLSA data, one of the sources of the increase in employment in the economy was foreign workers, who are employed in a number of sectors, mainly industry, construction and real estate. Nevertheless, their growth has been less significant this year than in 2005.[30] Detailed analyses of this phenomenon reveal that the employment of foreign workers was not directly linked with the Czech Republic's accession to the EU, but was related to labour demand from the skills, profession and costs perspectives.

The gradual improvement in the situation on the labour market for cyclical reasons has not yet led to a substantial narrowing of the regional, skills and professional gaps between the supply of, and demand for, labour. The share of long-term unemployed[31] in the total number of unemployed people under LFS methodology remained above 50%, although it showed a slight decline in Q1.

III.6.2 Wages and productivity

Table III.7
Average monthly nominal wage growth picked up significantly in 2006 Q1
(annual percentage changes)

	2005 Q1	2005 Q2	2005 Q3	2005 Q4	2006 Q1
Average wage in monitored organisations					
nominal	5.7	5.3	6.2	4.6	6.9
real	4.0	3.7	4.2	2.2	4.0
Average wage in business sector					
nominal	4.8	5.3	5.5	4.7	7.2
real	3.1	3.7	3.5	2.3	4.2
Average wage in non-business sector					
nominal	8.9	5.5	8.6	4.5	6.0
real	7.1	3.9	6.6	2.0	3.1
Whole-economy labour productivity	4.8	5.3	5.2	5.9	7.1
Nominal unit wage costs	0.7	0.1	1.5	-0.4	-0.3

Growth in average nominal and real wages picked up considerably in 2006 Q1. Compared to the previous quarter, the annual rate of growth of the average nominal wage increased by 2.3 percentage points year on year to 6.9%. Given the higher annual inflation, real wage growth was less pronounced, amounting to 4%. The relatively large increase in average nominal wages in 2006 Q1 was attributable to both of the sectors monitored, although the contribution of the business sector was greater.

The business sector has the most significant effect on average wages in the economy, as it employs more than three-quarters of the employees in the monitored

[28] Since January 2006, higher penalties have been imposed for failure to comply with the duty to report vacancies to labour offices. Similarly, the number of reported vacancies increased for administrative reasons at the end of 2004 following the coming into force of the new Employment Act in October 2004.

[29] Of 28,000 year on year, while the number of employed people under LFS methodology is 81,000 higher.

[30] According to MLSA figures, the number of registered foreign workers increased by 43,800 in 2005, while an increase of mere 8,500 was recorded in the first five months of 2006. The employment of foreign workers is also indicated by balance of payments data on compensation of employees paid to non-residents.

[31] i.e. those unemployed for more than one year.

organisations. Wages in the business sector are usually smoother, as they are affected by the competitive environment and by financial results. In 2006 Q1, however, the average nominal wage growth in the business sector was above the average increase for the previous two years. Nevertheless, the increase in its annual growth – of 2.5 percentage points to 7.2% compared to the previous quarter – was partly affected by the previous year's low base and a higher number of working days (2 days more than in 2005 Q1). These extraordinary factors were also indicated by slower growth in average hourly earnings according to the MLSA statistics, which amounted to 5.4%.[32]

The structural wage trends remained very mixed. The reasons for the persisting sectoral differentiation remained the same as in previous quarters. The differences in wage growth rates were due mainly to differences in productivity growth, the impact of external cost pressures stemming from growing energy prices, the level of competition in individual branches and also to the options available for reducing wage cost-output ratios in other ways, for example, by employing foreign workers with lower wage demands. As regards sectors, the fastest growing average wages were recorded in market services, while wages in industry and construction grew more slowly than the overall growth in average wages in the business sector.

Average nominal wage growth in the non-business sector was slower in 2006 Q1, amounting to 6%. Average wages are usually less smooth in this sector, as they depend mainly on administrative measures taken by the government and the capacities of the state budget. In 2006 Q1, the fastest growing average wages in the non-business sector were in health, veterinary and social work. The year-on-year growth in health (10.5%) was most affected by an extraordinary increase in wage scales as from September 2005, while wages in public administration, defence and compulsory social security showed slower growth (5.5%).

The most important factor as regards inflation, though, is how wages develop in relation to productivity indicators. The first quarter of 2006 saw a sizeable pick-up in annual whole-economy productivity growth, reaching above-average values in terms of previous years (7.1%).[33] The high growth was a result of increasing economic output accompanied by only a slight increase in employment. Rapid productivity growth continued mainly in industry, where it reached an extraordinary 15% despite increased employment. This growth was largely associated with the development of mainly export-oriented production supported by foreign direct investment and with the stronger external and domestic demand. Productivity also showed sizeable growth in market services.

The high growth in productivity fostered a reduction in the personnel cost-output ratio. Although average real wages increased more markedly in 2006 Q1 than in the previous quarter, they continued to grow much more slowly than productivity (see Table III.7). Not even nominal unit wage costs indicated any build-up of potential inflationary pressures stemming from wage developments in the economy, as they fell in year-on-year terms for the second consecutive quarter (0.3% in Q1). The much slower growth in average wages than in GDP suggested that the rapid growth in productivity had passed through to wages only partially. In particular, industry saw a relatively large difference between the growth rates of average real wages and productivity and nominal unit wage costs recorded a marked annual fall (of 7.5%). One of the causes of the falling personnel cost-output ratio was continuing growth in corporate costs, in particular energy input costs.

Chart III.41
Productivity growth in 2006 Q1 was highest in industry
(annual percentage changes)

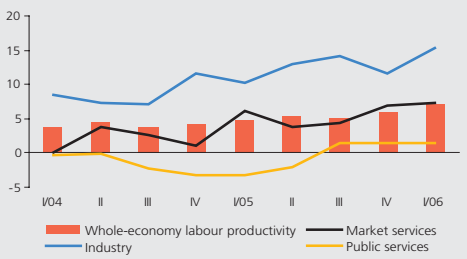
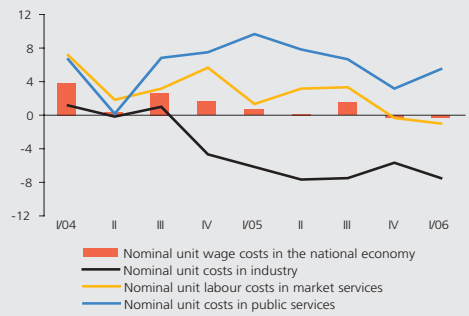


Chart III.42
Nominal unit wage costs again decreased slightly in 2006 Q1
(annual percentage changes)



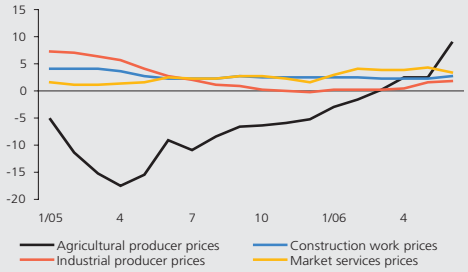
32 Data from the Average Earnings Information System.

33 Value added at constant prices per employed person under national accounts methodology.

III.7 IMPORT PRICES AND PRODUCER PRICES

Persisting buoyant growth in prices of energy-producing materials on world markets in 2006 Q1 and in the first two months of Q2 indicated continuing external cost pressures. Although growth in import prices of mineral fuels moderated, it remained high. However, as in previous quarters, the pass-through of these prices into domestic producer prices was significant only in oil-product-processing sectors at the initial stages of the production chain. This was indicated by generally faster, but still relatively modest growth in producer prices in industry as a whole. In some branches of manufacturing, however, their anti-inflationary effect gradually weakened. As for the other industrial branches, the only fast growth in producer prices was recorded in power generation. Faster price growth was also recorded by agricultural producers, some market services and, at the end of Q2, construction work.

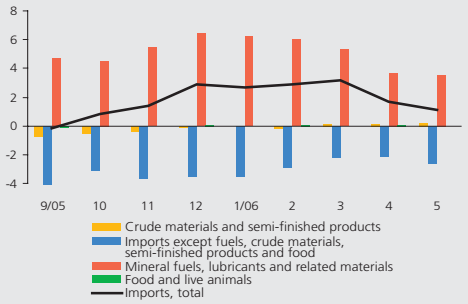
CHART III.43
Producer prices increased year on year in most of the monitored sectors in 2006 Q2
(annual percentage changes)



III.7.1 Import prices

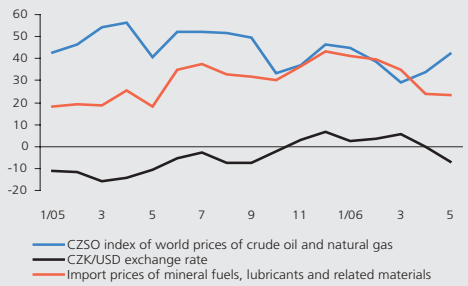
Import prices, which are an important factor of domestic inflation, indicated a continuing rise in prices of imported commodities in 2006. According to the latest CZSO figures, their annual growth was rising until March (to 3.2%), but slowed noticeably in the following two months (to 1.1% in May). The continuing rise in import prices and the slowdown in April and May were both mainly due to fast yet volatile growth in prices of energy-producing materials on world markets. Prices of other imported commodities mostly fostered a decline in annual import price inflation (see Chart III.44).

CHART III.44
The continuing rise in import prices was primarily a result of rapidly rising prices of energy-producing materials on world markets
(annual percentage changes; contributions in percentage points)



In 2006 Q1, annual growth in world prices of energy-producing materials slowed substantially from values exceeding 40% in January to 29.3% in March. However, it rebounded in the following two months and again exceeded 40% in May. This fluctuation was largely due to oil prices on world markets, which in May again grew faster than natural gas prices. Growth in import prices of mineral fuel imports slowed significantly in the first two months of Q2 (to 23.3% in May). They were affected by a marked year-on-year appreciation of the koruna-dollar exchange rate in this period, as shown in Chart III.45.

CHART III.45
The koruna-dollar exchange rate only partly dampened the impacts of the rapidly rising prices of energy-producing materials on domestic prices in 2006 Q2
(annual percentage changes)



Unlike prices of energy-producing materials, import prices of mineral commodities except fuels have been declining year on year since the start of 2006. This decline has gradually been deepening since January and reached 8.9% in May. Underlying this have been mostly falling year-on-year prices of an important component of imports of non-energy-producing materials – iron ore – as prices of most other raw materials except fuels have recorded marked annual growth on world markets, which picked up further in Q2.[34] Prices of food imports predominantly showed modest growth between the start of 2006 and May (0.2% year on year in May). An annual decline in prices prevailed in the other import categories at the start of 2006, although prices here declined to a lesser extent overall than at the end of 2005.

Prices of imported commodities with a higher degree of processing[35] also showed a year-on-year decline in 2006 Q1 and in the first two months of Q2, albeit to a lesser extent than in 2005. Prices in this import category were most affected by machinery and transport equipment, the highest-weight category (see Table III.8). The long-term gradual abatement of the year-on-year decline in prices was

[34] According to the CZSO world price index, prices of metals (excluding iron ore) increased by 76.6%, rubber by 71.8% and food and oils by 14.6% year on year in May.

[35] This category mainly includes machinery and transport equipment, manufactured goods, miscellaneous manufactured articles and chemicals and related products.

probably closely related to faster growth in industrial producer prices in the Czech Republic's major trading partner countries, which was, however, largely offset by the persisting relatively high year-on-year appreciation of the koruna-euro exchange rate.[36] The decline in prices of machinery and transport equipment imports was mostly moderate in 2006; its acceleration in May was probably due to the appreciation of the koruna-euro exchange rate. A similar trend was recorded for miscellaneous manufactured articles. Prices of manufactured goods have shown a slight increase since March (2.3% in May).

The generally mixed developments in import prices across the individual categories of the CZSO import price index implied different impacts on the individual producer and consumer price categories. Only import prices of energy-producing materials grew fast, exerting significant external upward cost pressures on domestic inflation. Prices in most other import categories continued to decrease year on year, thus having anti-inflationary effects on domestic prices. The upturn in prices of some imported inputs, however, suggested a weakening of their anti-inflationary effect.

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

	12/05	1/06	2/06	3/06	4/06	5/06
Imports, total	2.9	2.7	2.9	3.2	1.7	1.1
Food and live animals	1.5	0.0	0.6	-0.8	0.8	0.2
Beverages and tobacco	-4.5	-3.6	-0.1	-4.5	-7.7	-8.3
Crude materials except fuels	1.4	-0.1	-3.2	-4.4	-5.9	-8.9
Mineral fuels and related products	43.1	41.3	39.6	35.0	23.9	23.3
Animal and vegetable oils	-10.8	-7.6	-8.0	-4.6	-3.0	-3.8
Chemicals and related products	-2.0	-1.9	-2.5	-1.5	-2.5	-2.7
Manufactured goods classified by material	-0.6	-0.1	-0.2	1.3	1.6	2.3
Machinery and transport equipment	-1.5	-1.3	-0.9	-0.4	-1.1	-2.3
Miscellaneous manufactured articles	-7.8	-8.4	-6.6	-5.5	-5.8	-6.7

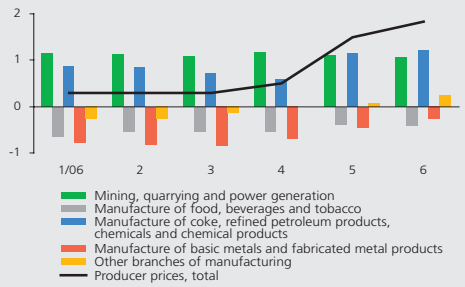
III.7.2 Producer prices

Industrial producer prices

The pick-up in annual industrial producer price inflation, observed since January 2006, continued into 2006 Q2. A further increase in the growth rate to 1.8% in June, i.e. of 1.5 percentage points compared to the end of Q1, was mainly due to faster growth in oil prices on world markets at the beginning of 2006.

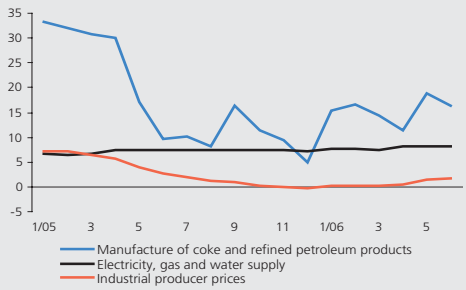
In 2006 Q2, the fastest growth was recorded for sectors involved in processing energy-producing materials and in power generation. Producer prices in the manufacture of coke and refined petroleum products, for which oil is the major cost input, recorded the largest increase (to 16.4% in June). Chart III.46 shows clearly that the high annual increase in prices in this sector was one of the main sources of the 1.8% rise in industrial producer prices in June. Another important source of annual price growth in industry was the continuing relatively high growth in producer prices in the electricity, gas and water supply industry, which rose to 8.2% in Q2 owing to higher prices of electricity for the corporate sector. The previous slight inflation of around 1% in mining and quarrying, which includes coal mining, turned into an annual price decrease in May (of 0.8%). It widened further to -1.7% in June.

Chart III.46
Industrial producer price inflation increased in 2006 Q2
(annual percentage changes; contributions in percentage points)



The other industries saw very mixed developments, although industries with slightly rising or declining prices predominated. Producer prices in the food industry continued to decline year on year in 2006 Q2, although again to a lesser extent than in the previous quarter (2.1% in June). This was mainly due to a slowing annual decline in domestic prices of crop products (cereals), a subsequent renewal of their growth, and a similar trend in food import prices. Prices in primary metal processing also saw a continuing moderation of their annual decline (to -1.9% in June), associated with the evolution of prices of some metals on world markets (see section III.7.1 *Import prices*). Most other manufacturing industries made a positive contribution to the overall industrial producer price index for the first time in two years. This change was probably linked partly with renewed growth in prices of some imported higher value added inputs.

Chart III.47
Producer prices recorded rapid growth only in branches involved in primary processing of oil products and power generation
(annual percentage changes)



The generally moderate growth in industrial producer prices in 2006 Q2 suggested that the pass-through of the continuing fast growth in producer prices in oil-

[36] The koruna-euro exchange rate appreciated by 5.8% year on year in 2006 Q2.

Chart III.48
Some branches of manufacturing are seeing an upswing in prices
(annual percentage changes; selected branches)

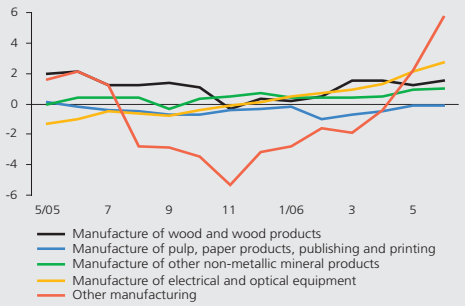


Chart III.49
The continuing recovery in agricultural producer prices was supported by rising prices of crop products
(annual percentage changes)

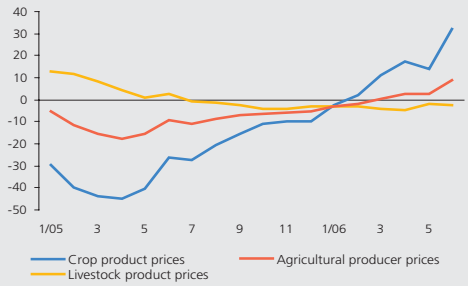
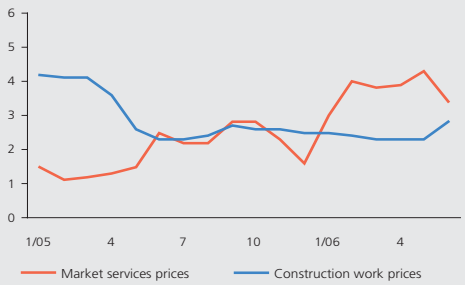


Chart III.50
Construction work prices picked up pace at the end of 2006 Q2
(annual percentage changes)



product-processing and power generation to producer prices in other industries remained subdued for most industries. This was mainly due to the industries' different demands for energy inputs and oil products, relatively rapid productivity growth in most sectors and other options available for cutting costs in the strongly competitive environment.[37] However, the weakening price decline or renewed growth in producer prices in the other manufacturing industries suggested at the same time that the recent anti-inflationary developments in industry could be gradually replaced by an inflationary trend.

Agricultural producer prices

Annual growth in agricultural producer prices picked up further in 2006 Q2 and recorded 8.8%.This was due to stronger growth in crop prices, whereas livestock product prices continued to record an annual decline.

The renewed annual growth in crop prices in February and their subsequent very rapid rise (to 32% in June) was a result of changes in prices of several products. The generally high growth in crop prices was fostered by a rise in the relatively volatile prices of vegetables and potatoes and also by sharp growth in fruit prices. Also important was a gradual upturn in annual growth in prices of cereals (to 5.7% in June). This was mainly due to the continuing elimination of the surplus from previous harvests on the agricultural market through exports and to base effects. Their buoyant growth was counteracted by the relatively high annual appreciation of the koruna-euro exchange rate, which reduced the koruna level of EU intervention prices.

Livestock product prices recorded a continuing annual decline in Q2, although this was more modest on average than in the previous quarter (see Chart III.49; -2.5% in June). In addition to the long-term annual appreciation of the koruna-euro exchange rate, which made imports to the domestic market cheaper, the decline in livestock product prices was due to the risk of transmission of epidemic poultry disease to consumers. This effect was indirectly transferred to the Czech Republic through price declines in some EU countries resulting from lower demand for poultry products. This factor caused a year-on-year fall in poultry prices in Q2 (of 8.9% in June). Prices of other livestock products also mostly fell in annual terms in Q2.

Other producer prices

Construction work price inflation was flat until May, staying at the end-Q1 level (2.3% year on year). This suggested that the previous slight slowdown in inflation, related mainly to prices of materials and products consumed in the construction industry, had probably halted. In June, construction work prices increased (by 2.8%) despite a continuing slight decline in prices of the main inputs. It is probable that the June increase in construction work prices was related to the evolution of demand, as indicated by a marked increase in construction work in May (of 11% year on year).

Market services price inflation in the production sector gradually increased until May (to 4.3%). In June it slowed to 3.4% due to base effects in postal and telecommunication services. In Q2, the most significant increases were recorded for prices for business services and real estate and rental activities. Their 5% annual rise was mainly due to fast growing prices for advertising, architectural and engineering services. Prices in insurance and financial intermediation also picked up in Q2 (to 2.6% in June).

[37] For example, by employing foreigners with lower wage demands.

IV.1 EXTERNAL ASSUMPTIONS OF THE FORECAST

Expectations regarding the external environment are one of the key assumptions of the forecast. For this purpose, the CNB has as usual drawn mainly on the publication Consensus Forecasts, which brings together the forecasts of a range of foreign analytical teams. The current forecast is based on the June data from this publication and the market information effective on the survey date.[38] However, the creation of the reference scenario has undergone significant modifications. Economic developments in the Czech Republic's major trading partner countries are now expressed using effective indicators of GDP and inflation in the euro area, which have replaced the former indicators for Germany (see Box 1). The reference scenario now includes an outlook for prices of Brent crude oil, which has replaced the outlook for Ural crude oil prices as the indicator of energy-producing material prices (see Box 2 below). The assessment of the external effects on the Czech economy in the near future is broadly the same as in the previous forecast. For 2007 it is somewhat less inflationary.

BOX 1
Effective indicators of external developments

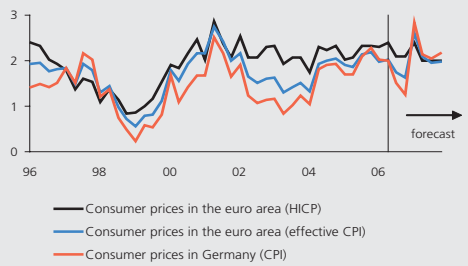
Since July 2006, the CNB forecast in the area of assumptions about external developments has been based on effective indicators for the euro area. The effective indicators for the euro area (the 11 member states excluding Luxembourg) describe external developments more comprehensively than the formerly used indicators of developments in the German economy. The fixed weights used to calculate the effective indicators are specified for the individual countries according to the average share of each country in foreign trade with the Czech Republic in 2005 (Germany 60.6%, Austria 10.1%, Italy 8.1%, France 7.3%, other countries less than 5%).

Effective indicators of GDP, consumer price inflation and producer price inflation are compiled for the needs of the forecast. Historical series for effective consumer price inflation and GDP are calculated on the basis of data from national statistical offices, while effective producer price inflation is based on Eurostat's harmonised data. Forecasts for all these indicators are derived from the Consensus Forecasts predictions.

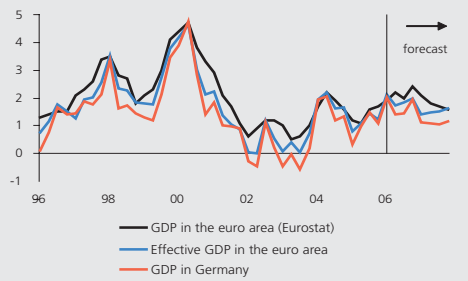
As shown in Charts 1 and 2 (Box), the effective indicators follow a similar pattern as the formerly used indicators for Germany. Nevertheless, effective inflation and GDP growth are both slightly higher on average over the whole period than the data for Germany, but lower than the standard euro area indicators. The introduction of an aggregate involving multiple countries dampens the impacts of specific factors, such as the VAT rate change in Germany, on foreign inflation and external demand. The difference between the individual effective indicators and the standard euro area indicators is mainly due to different weights, although in the case of consumer price inflation it is also due to the specific index used (the CPIs, not HICPs, for each country are used to calculate consumer price inflation).

The equilibrium variables in the core prediction model have been adjusted in line with the differences observed between the effective indicators and the indicators for Germany in order to prevent any unfounded shift in view regarding past and future developments.

GRAPH 1 (BOX)
The effective inflation indicator was slightly higher in the past than inflation in Germany
(annual percentage changes; source: Eurostat, national statistical institutes)



GRAPH 2 (BOX)
The effective GDP growth indicator was slightly higher in the past than GDP growth in Germany
(annual percentage changes; source: Eurostat, national statistical institutes)



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

Table IV.1
Economic growth will decrease in the euro area in effective terms

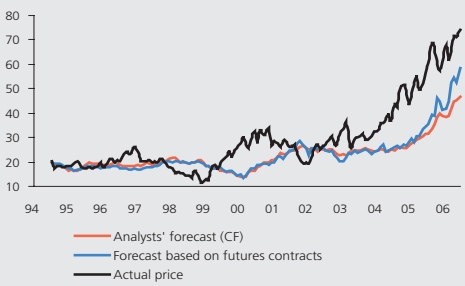
	III/06	IV/06	I/07	II/07	III/07	IV/07
Brent crude oil prices (USD/barrel)	70.1	72.0	72.8	72.9	72.6	72.1
ARA petrol prices (USD/t)	710.0	650.0	659.0	728.0	746.7	672.2
Effective indicator of GDP in euro area (annual, in per cent)	1.8	2.0	1.4	1.5	1.5	1.6
Effective indicator of producer price inflation in euro area (annual, in per cent)	5.0	4.0	3.0	1.7	2.5	2.9
Effective indicator of consumer price inflation in euro area (annual, in per cent)	1.7	1.6	2.6	2.1	1.9	2.0
Nominal USD/EUR exchange rate (in per cent)	1.280	1.288	1.293	1.298	1.302	1.301
1Y EURIBOR (in per cent)	3.4	3.5	3.5	3.6	3.7	3.7

According to the new reference scenario, the effective indicator of consumer prices in the euro area will grow by 1.8% this year and 2.2% in 2007. The main reason for the higher growth in 2007 is a price increase in Germany due to a VAT rate change. Inflation in the other euro area countries will mostly slow down in 2007. The increase in VAT in Germany should not exert upward pressures on import prices in the Czech Republic. This effect is therefore adjusted for in the forecast. Growth in the effective indicator of producer prices in the euro area is expected to slow from 4.6% this year to 2.2% in 2007. Economic growth in the euro area in effective terms will decline from 1.9% this year to 1.5% next year, mainly as a result of the impacts of the tax change on consumer demand in Germany.

The outlook for Brent crude oil prices foresees a slight increase at the one-year horizon, with the price staying above USD 70 per barrel until the end of 2007. In Q2, the average petrol price reached a level 5.9% higher than had been assumed by the reference scenario of the April forecast. The new outlook for petrol prices increased by 6% on average over the whole horizon and assumes continuing modest growth in prices.

The expected dollar-euro exchange rate reflects the weakening of the dollar in Q2 and the unchanged assumption that it will continue to depreciate gradually to USD 1.3 against the euro at the one-year horizon. The implied one-year EURIBOR trajectory is slightly lower than assumed in the previous forecast.

Graph 1 (Box)
Futures contracts predict the future WTI crude oil price better than analysts
(USD/barrel)



BOX 2
Oil and petrol prices in the CNB forecast

Starting with this forecast, the CNB's forecasting system uses the market outlook for the Brent crude oil price, which thus replaces the formerly used Ural crude oil price derived from the Consensus Forecasts (CF) survey. In addition, the forecasting system as from April also uses fuel prices taken from swap contracts on exchanges in north-western Europe (the ARA – Amsterdam-Rotterdam-Antwerp – exchanges).

Under the new scheme, oil and petrol prices are derived from quotations of futures contracts determined as of the Consensus Forecasts (CF) survey date in order to maintain consistency with the other indicators of external developments. Whereas the CF forecast is only available for the three-month and one-year horizons (meaning that developments at other horizons have to be calculated), quotations of futures contracts are available several years ahead at monthly frequency. The expected future development of oil and petrol prices calculated on the basis of such quotations is thus better defined. Moreover, a CNB analysis has revealed that futures contracts have since 2004 predicted future WTI oil prices (the only oil price indicator contained in CF) considerably better than the analysts' estimates in the CF survey, especially at the longer horizon – see Chart 1 (Box).

The results of simulated forecasts for the index of import prices of energy-producing materials based on prices of various types of oil have proved that Brent crude oil has the highest explanatory power. Likewise, oil prices on the exchanges in north-western Europe (ARA) are the best available indicator for estimating retail fuel prices at petrol stations in the Czech Republic.

IV.2 INTERNAL ASSUMPTIONS OF THE FORECAST

In addition to assumptions regarding the external environment, assumptions about the effects of domestic fiscal policy are an important input to the forecast. The current forecast does not revise the assumptions regarding fiscal developments and their effect on economic activity at the forecast horizon. The public finance deficit under ESA95 methodology is expected to be 2.4% of GDP in 2006 and 3% of GDP in 2007. The contribution of fiscal policy to economic growth will thus be positive in both years. At the forecast horizon, no sizeable additional fiscal stimulus is expected from the inflow of money from EU funds.

Another factor determining the message of the forecast consists of assumptions regarding the equilibrium values of key macroeconomic variables, especially real interest rates and the real exchange rate, and regarding the non-accelerating inflation level of output. These variables are used to derive the current position of the economy in the business cycle and the current settings of the monetary conditions. The evolution of the equilibrium variables also provides a framework for the fundamental orientation of the forecast. Among other things, an analysis of past and present developments in economic activity, inflation, the exchange rate and interest rates is 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.

Compared to the previous forecast, only a minor revision was made to the equilibrium variables. The estimate of the rate of equilibrium real appreciation lies at present and at the forecast horizon between 3.5% and 4%, with a gradually declining tendency. The equilibrium annual real money market interest rate is slightly below 1% and is also declining at the forecast horizon. In the context of the revised GDP data, the high observed economic growth rates and the continuing absence of major demand pressures, the estimated long-term growth rate of the non-accelerating inflation level of output has been revised upwards to 5% since the last forecast. In this connection, its current growth rate has been revised slightly to just above 5.5%. At the forecast horizon, this rate declines gradually to its long-term level.

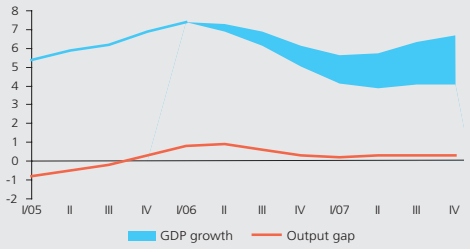
In previous quarters, the buoyant economic activity led to a rapid closing of the output gap. The economy is currently above the non-accelerating inflation level of output. In 2006 H1, GDP growth is still being driven by improving net exports, although the lead of export growth over import growth has decreased significantly. Investment growth has picked up and consumption is also recovering. The contribution of government consumption to domestic demand growth remains negligible.

In 2006 Q2, consumer prices grew faster than predicted in the April forecast. They continued to be affected by contrary movements in energy prices and other import prices, while the exchange rate of the koruna had a strong anti-inflationary effect. Faster-than-expected growth was recorded particularly for food prices, regulated prices and fuel prices. Adjusted inflation excluding fuels suggests that the potential moderate inflationary pressures resulting from the rising demand and inflation expectations have so far been fully offset by the evolution of the exchange rate. Nonetheless, the first slight indications of indirect effects of the oil and energy price growth on consumer prices are observable, although so far in only a limited number of categories.

The settings of the real monetary conditions in 2006 Q2, which affect the course of the business cycle in the coming quarters, can be described as neutral to very slightly tight overall, largely as a result of a tightening of the exchange rate component during 2006. The effect of the interest rate component has been viewed as neutral to slightly easy for several quarters.

IV.3 THE MESSAGE OF THE FORECAST

Chart IV.1
The output gap remains positive
(annual percentage changes; percentages of GDP; seasonally adjusted)



The continuing fast growth in economic activity in recent quarters has led to an increase in the estimated growth rate of the non-accelerating inflation level of output and also to a revision of the initial output gap to more positive levels. A tight exchange rate component of the monetary conditions and a weak external recovery will counteract any further growth of the output gap, but a gradual easing of the monetary conditions and a positive contribution from fiscal policy will help to keep it in positive values. Annual average real GDP growth will thus be 6.6% in 2006 and 5.1% in 2007.

Household consumption will pick up in the next few quarters, chiefly thanks to favourable developments on the labour market and faster growth in disposable income of households. Despite a slowdown in unemployment growth and the dampening effects of employment of people with lower wage demands, wage and salary growth in the business sector will remain high in 2006 and 2007. Sizeable growth in transfers in 2007 will foster a further rise in nominal disposable income growth. In real terms, however, disposable income growth will be dampened by higher inflation. The lagged effect of the easy interest rate component of the monetary conditions will be reflected in a decline in the gross saving rate below 7%, thus allowing real consumer spending to increase by 3.8% in both 2006 and 2007. The forecast for nominal government consumption expenditure has undergone no major revision. In real terms, however, it has been decreased, owing to a revision of the deflator. Government consumption will thus grow by 0.4% in 2006 and fall by 1.2% in 2007.

Table IV.2
Unemployment will continue falling
(annual percentage changes)

	2006	2007
Real disposable income of households	3.0	3.9
Unemployment rate (in per cent)	8.9	8.7
Labour productivity	5.6	4.3
Current account deficit (ratio to GDP in per cent)	-2.3	-1.5
M2	8.5	7.4

Growth in gross fixed capital formation will remain roughly at its current levels over the forecast period. Investment activity in the private sector will continue to be supported primarily by FDI inflows. Higher growth will be counteracted by a gradual tightening of real interest rates. A positive contribution from public sector capital expenditure is also expected in both years. Gross fixed capital formation will increase by 7.2% in 2006 and 6.0% in 2007.

Table IV.3
Economic growth will slow in 2007
(annual percentage changes)

	2006	2007
Gross domestic product	6.6	5.1
Household consumption	3.8	3.8
Government consumption	0.4	-1.2
Gross fixed capital formation	7.2	6.0
Imports of goods and services	12.4	8.3
Exports of goods and services	14.0	9.8
Net exports of goods and services (in CZK bn, at constant prices)	-16.3	19.0

The growth trend in export performance, connected with FDI inflow and related changes on the supply side of the economy, will continue into 2006 H2 and 2007. An external demand recovery in 2006 H1 and the launching of new export-oriented production facilities will help increase the annual rate of growth of real exports in 2006 to 14%, despite a tight real exchange rate. Conversely, a gradual easing of the real exchange rate will not fully offset a cooling of the external recovery in 2007 and real export growth will slow to just below 10%. A pick-up in domestic demand, and particularly in domestic investment activity, will cause the annual rate of growth of real imports to rise above 12% in 2006. In 2007, the growth will slow slightly, to 8.3%. Thanks to the continuing lead of real export growth over real import growth, the net export deficit at constant prices will decrease further in 2006 and turn into a surplus in 2007.

At the forecast horizon, the exchange rate of the koruna against the euro will be close to its current levels and the depreciation pressures stemming from the negative interest rate differential vis-à-vis other currencies will be balanced by the appreciation pressures associated with the long-term equilibrium appreciation of the real exchange rate amid higher domestic inflation.

The expected inflation path is determined by the combined demand-pull pressures resulting from real economic activity, imported inflation and other exogenous factors. The inflation forecast for 2006 and 2007 has been increased slightly. At the nearest horizon, this revision primarily reflects the higher-than-expected growth in food prices and regulated prices in 2006 Q2. Higher inflation will also be fostered by more inflationary cost and demand factors over the entire forecast horizon and

a modest increase in the outlook for administered prices in 2007. In the remainder of 2006, inflation will fluctuate just below the 3% level, but in the course of 2007 it will increase further. At the monetary policy horizon, it lies very close to the upper boundary of the tolerance band of the point inflation target.

Consumer price inflation in 2006 and 2007 will be affected primarily by growth in regulated prices and the impact of changes to indirect taxes (harmonisation changes to excise duties on tobacco products). The overall contribution of administrative effects, i.e. the changes to indirect taxes and regulated prices, to annual inflation will amount to roughly 1.9 percentage points at the end of both 2006 and 2007. During the forecast period, adjusted inflation will increase as a result of rising inflation expectations, an unwinding of the anti-inflationary effect of the exchange rate and moderate inflationary pressures from the real economy. As in the previous forecast, only partial pass-through of the second-round effects of the growth in energy prices and regulated prices to other price categories is assumed. Food prices will also grow at a faster pace than observed to date. The average inflation rate will be 2.8% in 2006 and rise to 3.7% in 2007.

The mechanism of caveats will as usual apply to the first-round effects of indirect taxes, whose impact will be particularly pronounced in 2007, amounting to almost 1 percentage point. Adjusted for these effects, inflation to which monetary policy reacts is very close to the point inflation target at the monetary policy horizon.

Consistent with the macroeconomic forecast and its assumptions is a gradual rise in interest rates.

Two sensitivity analyses were conducted while the forecast was being prepared. One analysis investigates the uncertainty in the outlook for foreign interest rates and the other, as usual, analyses the impact of a deviation of the exchange rate on the message of the forecast. An alternative scenario was drawn up at the same time. This responds to the general risk associated with correctly identifying inflationary pressures from the real economy.

Inflationary pressures from the real economy are reflected in the real marginal cost gap, which consists of the costs arising from the volume of production given falling returns to scale (the output gap) and the production factor costs of labour per unit of production (the real wage gap). The CNB's current core prediction model assumes pro-cyclical real wage behaviour and approximates the real marginal cost gap using the output gap only. The alternative scenario uses the core prediction model extended to include wage costs in conditions of sticky nominal wages. This relaxes the assumption regarding pro-cyclical real wages and allows us to estimate the starting conditions and model the inflationary pressures using both components of real marginal costs.

With almost an identical past evolution of real monetary conditions as in the baseline scenario, the alternative scenario identifies a similar output gap as well. The real wage gap is assessed as anti-inflationary, despite a modest pick-up in nominal wage growth in the recent period. Real wages are below their equilibrium level and are not exerting any upward pressure on prices for producers. The overall real marginal cost gap is thus only very slightly inflationary at present and the inflationary pressures are lower than in the baseline scenario.

In the alternative forecast, the real wage gap remains negative as a result of the sticky nominal wages amid rising inflation, and the real marginal costs exert anti-inflationary pressures over most of the forecast horizon. These pressures counteract the rising inflation expectations and suppress the rise in inflation. The forecast for headline inflation and for inflation adjusted for the first-round effects of tax changes is somewhat lower in the alternative scenario than in the baseline scenario. Rates remain on an upward path, however.

Table IV.4
Adjusted inflation excluding fuels will rise
(annual percentage changes)

	III/06	IV/06	I/07	II/07	III/07	IV/07
Annual consumer price inflation	2.9	2.7	3.2	3.3	4.0	4.1
Breakdown into contributions:						
regulated prices	9.9	6.0	5.3	4.5	4.3	4.3
indirect taxes (contributions in p.p.)	0.5	0.6	0.3	0.5	1.0	0.9
food prices, excluding changes to indirect taxes	-0.1	0.9	2.7	2.7	2.2	2.2
fuel prices, excluding changes to indirect taxes	0.9	1.2	9.1	2.3	0.9	1.1
adjusted inflation excluding fuels, excluding changes to indirect taxes	0.6	1.1	1.6	2.2	2.8	3.1

Chart IV.2
The inflation forecast is close to the upper boundary of the tolerance band of the point inflation target at the monetary policy horizon
(annual percentage changes in CPI)

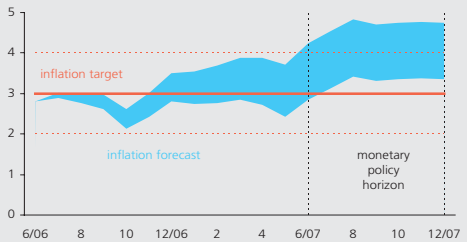
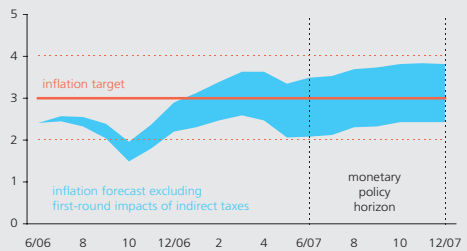


Chart IV.3
Excluding the first-round impacts of indirect taxes, inflation is very close to the point inflation target at the monetary policy horizon
(annual percentage changes)



IV.4 EXPECTATIONS OF ECONOMIC AGENTS

The CNB monitors inflation expectations at two horizons - one year and three years. The inflation expected by financial market participants at the one-year horizon increased slightly in Q2, but remained below the CNB's inflation target. Analysts predict that the expected growth in regulated prices in 2006 and 2007 will remain the main inflation factor. The slight increase in inflation expectations was due to a pick-up in economic growth with possible demand-pull inflationary pressures. Higher oil prices pose another possible upside risk to inflation. The relatively strong koruna remains the most substantial downside factor. The inflation expectations of corporations and households also rose at the one-year horizon.

At the three-year horizon, the inflation expectations of the financial market are below the CNB's inflation target of 3%. The data for corporations exceed this level only slightly. The highest inflation is expected by households, but their expectations have long been highly volatile.

Expected interest rates showed minimal changes in the period under review over virtually the entire length of the yield curve. The interest rate path consistent with the aforementioned CNB forecast was above the path expected by financial market analysts over the entire horizon (the longer the horizon, the wider the deviation).

Table IV.5

The inflation expectations of the financial market and corporations were below the CNB's target

(percentages)

	12/05	3/06	4/06	5/06	6/06
Consumer price index					
1Y horizon:					
Financial market	2.6	2.5	2.6	2.6	2.8
Corporations	2.8	2.7			2.9
Households	4.6	4.1			5.9
3Y horizon:					
Financial market	2.5	2.4	2.4	2.5	2.4
Corporations	2.9	2.9			3.1
Households	5.2	6.2			9.4
1Y PRIBOR					
1Y horizon:					
Financial market	2.8	2.8	2.9	2.8	2.9

MINUTES OF THE BOARD MEETING ON 25 MAY 2006

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

The Board was presented with the May situation report, which assessed the new information and the risks associated with the fulfilment of the April macroeconomic forecast.

Consumer prices had risen by 2.8% year on year in April in line with the current forecast. The dynamics of the individual components of inflation had also been as predicted. Rather lower growth in fuel prices had been offset by only slightly faster growth in administered prices. Adjusted inflation excluding fuels had been in line with the forecast, as had industrial producer prices, agricultural producer prices and import prices.

Newly available information concerning the supply side and foreign trade and from business surveys signalled no major risks to the fulfilment of the April GDP forecast. The forecast expected a further pick-up in annual GDP growth in 2006 Q1. This prediction was confirmed by short-term projection methods based on leading and coincident indicators. Industrial production had risen by 15.4% year on year in 2006 Q1, the highest figure since 1998. Labour market indicators were in line with the current forecast. A deviation from the forecast was observable for the nominal exchange rate, which so far in Q2 had been stronger on average than assumed in the forecast.

After the presentation of the situation report, the Board discussed the risks to the fulfilment of the April forecast. The Board agreed that the inflation risks had not moved since the April meeting. The risks to the forecast were moderate and balanced and the monetary policy rate settings were in line with expected economic developments. The Board agreed that it viewed the exchange rate as a downside risk to inflation. It was said that the appreciation of the koruna could be explained to some extent by the accelerating GDP growth and the positive evolution of the trade balance. Uncertainty was expressed about the economy's resilience to the relatively significant strengthening of the exchange rate. This resilience had increased over time, but no doubt had its limits.

The Board went on to discuss the equilibrium real appreciation rate. It was said that the theory derives the equilibrium real appreciation rate *inter alia* by means of the Balassa-Samuelson effect and that in empirical analyses of 1990s data this effect had been identified as very small for the Czech economy. Against this, it was pointed out that prices of nontradable goods were rising much faster than prices of tradable goods, which might suggest a more significant Balassa-Samuelson effect.

The Board then discussed the potential impacts of the current decline in prices of some assets on global markets. In this context, it was said that the Czech financial market could be affected by these developments. The opinion was expressed that the current decline in asset prices on some markets was not a major risk, but rather a necessary correction.

The Board went on to discuss the external environment and its effects on the Czech economy. Attention was drawn to the accelerating inflation in various parts of the world. Growth in interest rates was also expected in the euro area. A global tightening of monetary policy by key central banks could lead to depreciation pressures on the koruna if domestic rates were not raised. Some of the board members nonetheless said that they did not expect any dramatic rise in interest rates in the euro area.

Part of the discussion was devoted to the elasticity of prices in industry, which will significantly affect overall inflation going forward. Attention was drawn to structural factors leading to divergence of industrial producer price inflation in the Czech Republic from that in its major trading partner nations.

The Board's discussion also touched on public finances. Concern was expressed about the growth in state budget expenditure. It was said that unless there was a major change in the present trend, the Maastricht convergence criteria might not be met.

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 29 JUNE 2006

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

The Board was presented with the June situation report, which assessed the new information and the risks associated with the April macroeconomic forecast.

Consumer prices had recorded higher annual growth in May (3.1%) than predicted in the April forecast (2.9%). The deviation had been due mainly to faster growth in administered prices and higher fuel prices in response to the evolution of world oil prices. An upswing in industrial producer price inflation chiefly reflected higher prices of energy-producing materials. Agricultural producer prices had been in line with the forecast in May.

The high GDP growth in 2006 Q1 had been in line with the prediction. Some deviations from the forecast had occurred in the structure of the economic growth. Household consumption had risen rather faster than forecasted, whereas government consumption had recorded a negative growth rate. Fixed investment had been in line with the forecast. The change in inventories had been considerably higher than expected. Conversely, net exports at constant prices had lagged behind the assumptions of the forecast. The available data from the labour market confirmed the favourable development of the economy. The unemployment rate in May had been 0.2 percentage points lower than forecasted. The higher demand for labour was starting to show up in a fall in the number of registered unemployed. The average nominal wage had risen 1 percentage point faster in 2006 Q1 than expected by the forecast.

After the presentation of the situation report, the Board began its discussion. The board members regarded the risks of the April forecast as being largely balanced and relatively low. Opinions were also expressed that the risks to inflation were skewed to the upside. The Board agreed that in line with the April forecast and current financial market expectations, there was a rising probability that the next interest rate movement would be upwards.

The Board's discussion focused on the factors that might affect inflation going forward. The domestic factors mentioned included the upswing in private consumption combined with the higher-than-predicted wage growth. However, the prevailing view was that risks of demand-pull inflation were not currently evident. Opinions were expressed that the higher wage growth was being offset by rising labour productivity. The risks were also limited because household consumption was still rising much more slowly than overall GDP. It was pointed out that in the situation of strong economic growth, manifestations of inflation pressures were being prevented by the simultaneously accelerating potential output, driven by the positive effects of foreign direct investment inflow.

The Board agreed that in the near future the inflation impulses would stem mainly from administered prices. A rise in bread prices would also have a one-off impact on inflation. Concern was expressed that inflation above 3% might affect inflation expectations. It was said that over the past year inflation in the Czech Republic had picked up much more than in numerous developing economies and in the euro area or the USA. On the other hand, it was argued that market participants would certainly take one-off measures and administered prices into account in the formation of inflation expectations.

The Board also discussed the external environment. It was said repeatedly that in the key economies inflation was rising moderately and interest rates were being gradually raised. The Czech Republic would probably not be able to buck this trend indefinitely. The widening of the negative interest rate differential might affect the exchange rate of the Czech koruna. In recent weeks its year-on-year appreciation had seen a correction.

The Board also discussed the prospects for economic growth in the Czech Republic. The majority of the board members were of the opinion that the current high growth rate is unlikely to be sustained in the longer term. In this context, attention was drawn to the risk of a deterioration in net exports, to the high rate of taxation and to the high degree of regulation and insufficient flexibility of the economy. The economic recovery in the euro area might help to maintain a higher growth path. It was also said that the future growth of the Czech economy and the perceptions of the prospects for the domestic economy by foreign entities depended on the launch of essential reforms.

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 27 JULY 2006

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

The Board discussed the July situation report containing the new macroeconomic forecast. According to the forecast, the economy was currently above the non-accelerating inflation level of output, whose rate of growth had been increased compared to the April forecast. The estimate of the output gap had been revised upwards relative to the previous forecast, fostering an increase in the inflation forecast. The inflation forecast also reflected growth in indirect taxes, to whose first-round effects monetary policy does not react.

At the monetary policy horizon, inflation was thus close to the upper boundary of the toleration band of the inflation target. The higher forecasted inflation was due to slightly higher growth in administered prices, to a rise in food prices caused, among other things, by growth in agricultural producer prices, and to higher fuel prices, reflecting the rise in oil prices. By comparison with the April forecast, the prediction for adjusted inflation excluding fuels was lower in the short term, primarily in response to an initially stronger exchange rate. In the longer term, conversely, it was higher owing to demand-pull inflation pressures caused by the revision of the output gap and owing to the second-round effects of the higher energy prices.

The economic growth forecast was higher for 2006 but slightly lower for 2007. Growth in net exports and growth in investment, linked, among other things, with the past inflow of foreign direct investment and the creation of new export facilities, would continue to have a positive effect. This factor would continue to favourably influence the Czech economy going forward. Expected growth in wages and employment would lead to a pick-up in household consumption growth.

Consistent with the July forecast and its assumptions was a gradual rise in interest rates.

After the presentation of the situation report, the Board discussed the uncertainties and risks associated with the forecast. The board members agreed that the revision of the current position of the economy in the business cycle was an uncertainty of the forecast. This was meanwhile one of the main factors affecting the forecast for growth of adjusted inflation excluding fuels. There was some discussion of the distribution of the current high economic growth between growth in the non-accelerating inflation level of output and growth in the output gap. Some of the board members expressed the view that the increase in the output gap in the forecast was too pronounced as compared to the observed adjusted inflation and other economic figures. Hence, the Board should defer raising interest rates until there were clearer signs of demand-pull inflationary pressures. Against this, opinions were expressed that the widening of the output gap was consistent with the evolution of related economic indicators, so the rise in interest rates should not be put off. Such an increase was also in line with developments abroad and with alternative analyses of the economy.

The Board also discussed the labour market situation and its impacts on wage and related inflation pressures going forward. The majority of the board members agreed that no such pressures were currently evident. In this context, particular mention was made of the fall in nominal unit wage costs, the growth in labour productivity and the rise in the number of hours worked. Against this, some of the board members identified the possibility of a rise in such pressures, mainly due to growing nominal wages, increased demand for work and falling unemployment. It was also said, however, that the openness of the Czech economy to foreign workers was a factor slowing wage growth and reducing this risk.

The board members assessed the uncertainty regarding the effects of fiscal policy going forward on both the revenue and, in particular, expenditure side of the public budgets. It was said that this was a major uncertainty and that it was impossible to determine its direction of effect in advance.

The Board also discussed the risk of appreciation of the exchange rate. The opinion was expressed that an increase in interest rates might lead to a strengthening of the exchange rate. Against this, it was said that the exchange rate response should not be all that strong, as an interest rate increase was expected.

After discussing the situation report, the Board decided by a majority vote to raise the two-week repo rate by 0.25 percentage point to 2.25% with effect from 28 July 2006. At the same time it decided to increase the discount rate and Lombard rate by the same amount, to 1.25% and 3.25% respectively. Four board members voted in favour of this decision, and three members voted for leaving rates unchanged.

Table 1a

INFLATION DEVELOPMENT												annual percentage changes
2002	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**
Consumer prices	3.7	3.9	3.7	3.2	2.5	1.2	0.6	0.6	0.8	0.6	0.5	0.6
Regulated prices	7.6	8.1	8.0	6.5	6.3	6.3	5.3	5.0	4.9	3.4	3.4	3.3
(contribution to consumer price inflation)	*1.49*	*1.60*	*1.59*	*1.28*	*1.24*	*1.22*	*1.05*	*0.98*	*0.98*	*0.69*	*0.69*	*0.66*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.05*	*0.05*	*0.05*	*0.05*	*0.05*	*0.05*	*0.05*	*0.05*	*0.00*	*0.00*	*0.00*	*0.00*
Net inflation	2.7	2.7	2.5	2.4	1.5	-0.1	-0.6	-0.6	-0.3	-0.1	-0.2	-0.2
(contribution to consumer price inflation)	*2.20*	*2.15*	*2.01*	*1.89*	*1.20*	*-0.12*	*-0.47*	*-0.46*	*-0.22*	*-0.11*	*-0.18*	*-0.15*
of which: prices of food, beverages and tobacco	3.2	3.0	2.3	1.7	0.6	-2.6	-3.6	-3.5	-2.9	-3.0	-3.2	-3.4
(contribution to consumer price inflation)	*0.88*	*0.82*	*0.65*	*0.47*	*0.16*	*-0.72*	*-0.97*	*-0.96*	*-0.79*	*-0.80*	*-0.87*	*-0.93*
adjusted inflation	2.5	2.5	2.6	2.7	2.0	1.1	0.9	0.9	1.1	1.3	1.3	1.5
(contribution to consumer price inflation)	*1.32*	*1.33*	*1.37*	*1.43*	*1.04*	*0.60*	*0.50*	*0.50*	*0.56*	*0.69*	*0.69*	*0.79*
Inflation rate (annual moving average)	4.6	4.6	4.6	4.5	4.3	3.9	3.5	3.1	2.7	2.4	2.1	1.8
2003												
Consumer prices	-0.4	-0.4	-0.4	-0.1	0.0	0.3	-0.1	-0.1	0.0	0.4	1.0	1.0
Regulated prices	-0.3	-0.8	-0.8	1.4	1.5	1.5	0.4	0.4	0.4	1.2	1.2	1.3
(contribution to consumer price inflation)	*-0.07*	*-0.15*	*-0.16*	*0.29*	*0.31*	*0.32*	*0.08*	*0.09*	*0.08*	*0.24*	*0.24*	*0.27*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*
Net inflation	-0.4	-0.2	-0.2	-0.5	-0.4	0.0	-0.2	-0.1	0.0	0.3	0.9	1.0
(contribution to consumer price inflation)	*-0.32*	*-0.17*	*-0.15*	*-0.38*	*-0.30*	*-0.01*	*-0.19*	*-0.10*	*-0.01*	*0.20*	*0.70*	*0.77*
of which: prices of food, beverages and tobacco	-4.1	-3.8	-3.5	-3.5	-2.8	-1.0	-0.9	-0.9	-0.1	0.6	2.5	2.7
(contribution to consumer price inflation)	*-1.06*	*-1.06*	*-0.97*	*-0.94*	*-0.76*	*-0.28*	*-0.22*	*-0.22*	*-0.04*	*0.16*	*0.66*	*0.70*
adjusted inflation	1.5	1.7	1.5	1.1	0.9	0.5	0.1	0.2	0.0	0.1	0.1	0.1
(contribution to consumer price inflation)	*0.74*	*0.89*	*0.82*	*0.56*	*0.46*	*0.27*	*0.04*	*0.12*	*0.02*	*0.04*	*0.04*	*0.06*
Inflation rate (annual moving average)	1.5	1.1	0.8	0.5	0.3	0.2	0.2	0.1	0.0	0.0	0.1	0.1
2004												
Consumer prices	2.3	2.3	2.5	2.3	2.7	2.9	3.2	3.4	3.0	3.5	2.9	2.8
Regulated prices	5.0	4.9	4.7	3.1	2.4	2.4	2.4	2.3	2.3	4.4	4.4	4.4
(contribution to consumer price inflation)	*1.01*	*0.99*	*0.96*	*0.63*	*0.49*	*0.49*	*0.49*	*0.47*	*0.46*	*0.90*	*0.89*	*0.89*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.35*	*0.35*	*0.35*	*0.39*	*0.61*	*0.68*	*0.72*	*0.73*	*0.76*	*0.76*	*0.76*	*0.76*
Net inflation	1.2	1.2	1.4	1.5	2.0	2.1	2.5	2.6	2.3	2.1	1.6	1.5
(contribution to consumer price inflation)	*0.96*	*0.92*	*1.15*	*1.21*	*1.63*	*1.71*	*2.02*	*2.11*	*1.81*	*1.71*	*1.28*	*1.20*
of which: prices of food, beverages and tobacco	2.8	2.8	3.2	3.3	3.4	2.7	3.8	4.2	3.0	2.2	0.7	0.9
(contribution to consumer price inflation)	*0.75*	*0.75*	*0.83*	*0.86*	*0.89*	*0.71*	*1.00*	*1.10*	*0.78*	*0.59*	*0.18*	*0.25*
adjusted inflation	0.4	0.3	0.6	0.6	1.4	1.9	1.9	1.9	1.9	2.1	2.1	1.8
(contribution to consumer price inflation)	*0.21*	*0.17*	*0.32*	*0.35*	*0.74*	*1.00*	*1.02*	*1.02*	*1.03*	*1.12*	*1.10*	*0.96*
Inflation rate (annual moving average)	0.3	0.5	0.8	1.0	1.2	1.4	1.7	2.0	2.2	2.5	2.7	2.8
2005												
Consumer prices	1.7	1.7	1.5	1.6	1.3	1.8	1.7	1.7	2.2	2.6	2.4	2.2
Regulated prices	2.9	2.9	2.9	3.1	4.0	5.8	6.6	6.8	6.8	9.0	9.0	9.0
(contribution to consumer price inflation)	*0.61*	*0.60*	*0.61*	*0.66*	*0.83*	*1.21*	*1.38*	*1.41*	*1.41*	*1.87*	*1.87*	*1.87*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.35*	*0.35*	*0.35*	*0.31*	*0.09*	*0.02*	*-0.02*	*-0.03*	*-0.06*	*-0.06*	*-0.05*	*0.00*
Net inflation	0.9	0.9	0.7	0.8	0.6	0.7	0.4	0.4	1.1	1.0	0.8	0.4
(contribution to consumer price inflation)	*0.72*	*0.75*	*0.59*	*0.68*	*0.46*	*0.53*	*0.35*	*0.35*	*0.89*	*0.80*	*0.65*	*0.32*
of which: prices of food, beverages and tobacco	0.4	0.6	0.4	-0.1	-0.1	0.2	-0.6	-0.6	-0.2	0.3	0.3	-0.7
(contribution to consumer price inflation)	*0.11*	*0.17*	*0.12*	*-0.02*	*-0.03*	*0.04*	*-0.15*	*-0.17*	*-0.05*	*0.07*	*0.08*	*-0.17*
adjusted inflation	1.1	1.1	0.9	1.3	0.9	0.9	0.9	1.0	1.8	1.4	1.1	0.9
(contribution to consumer price inflation)	*0.61*	*0.59*	*0.47*	*0.69*	*0.49*	*0.48*	*0.50*	*0.52*	*0.94*	*0.74*	*0.57*	*0.49*
Inflation rate (annual moving average)	2.8	2.7	2.6	2.6	2.5	2.4	2.2	2.1	2.0	2.0	1.9	1.9
2006												
Consumer prices	2.9	2.8	2.8	2.8	3.1	2.8						
Regulated prices	11.0	11.0	11.2	11.5	12.4	10.5						
(contribution to consumer price inflation)	2.27	2.28	2.30	2.37	2.55	2.19						
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.21*	*0.34*	*0.39*	*0.39*	*0.39*	*0.39*						
Net inflation	0.5	0.3	0.1	0.1	0.3	0.3						
(contribution to consumer price inflation)	*0.40*	*0.23*	*0.08*	*0.09*	*0.22*	*0.24*						
of which: prices of food, beverages and tobacco	-1.0	-1.6	-1.8	-1.5	-1.3	-0.6						
(contribution to consumer price inflation)	*-0.25*	*-0.41*	*-0.47*	*-0.39*	*-0.34*	*-0.15*						
adjusted inflation	1.2	1.2	1.0	0.9	1.1	0.7						
(contribution to consumer price inflation)	*0.65*	*0.64*	*0.55*	*0.48*	*0.56*	*0.39*						
Inflation rate (annual moving average)	2.0	2.1	2.2	2.3	2.4	2.5						

CNB calculation based on CZSO data

Table 1b

INFLATION DEVELOPMENT												monthly percentage changes
2002	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**
Consumer prices	1.5	0.2	-0.1	-0.1	-0.1	-0.3	0.5	-0.2	-0.5	-0.3	-0.2	0.2
Regulated prices	3.7	0.8	0.2	-1.1	-0.1	0.0	1.1	0.0	0.1	-1.3	0.0	-0.1
(contribution to consumer price inflation)	*0.75*	*0.16*	*0.04*	*-0.23*	*-0.03*	*0.00*	*0.23*	*-0.01*	*0.03*	*-0.26*	*0.00*	*-0.02*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*
Net inflation	0.9	0.0	-0.2	0.2	-0.1	-0.3	0.3	-0.2	-0.7	0.0	-0.1	0.2
(contribution to consumer price inflation)	*0.74*	*-0.03*	*-0.14*	*0.20*	*-0.11*	*-0.24*	*0.20*	*-0.19*	*-0.58*	*0.01*	*-0.11*	*0.13*
of which: prices of food, beverages and tobacco	1.5	-0.4	-0.5	0.1	-0.3	-1.2	-1.9	-1.0	-0.1	0.0	-0.3	0.7
(contribution to consumer price inflation)	*0.41*	*-0.11*	*-0.14*	*0.01*	*-0.08*	*-0.32*	*-0.50*	*-0.25*	*-0.03*	*-0.01*	*-0.08*	*0.18*
adjusted inflation	0.6	0.2	0.0	0.3	-0.1	0.2	1.3	0.1	-1.0	0.0	-0.1	-0.1
(contribution to consumer price inflation)	*0.33*	*0.08*	*0.00*	*0.18*	*-0.04*	*0.08*	*0.70*	*0.07*	*-0.56*	*0.02*	*-0.03*	*-0.05*
2003												
Consumer prices	0.6	0.2	-0.1	0.2	0.0	0.0	0.1	-0.2	-0.5	0.1	0.5	0.2
Regulated prices	0.1	0.3	0.2	1.1	-0.1	0.0	0.0	0.0	0.1	-0.4	0.0	0.0
(contribution to consumer price inflation)	*0.03*	*0.06*	*0.03*	*0.23*	*-0.01*	*0.01*	*0.00*	*0.00*	*0.01*	*-0.09*	*0.00*	*0.00*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*
Net inflation	0.7	0.2	-0.2	0.0	0.0	0.1	0.0	-0.1	-0.6	0.3	0.5	0.3
(contribution to consumer price inflation)	*0.55*	*0.14*	*-0.13*	*-0.03*	*-0.04*	*0.05*	*0.03*	*-0.11*	*-0.49*	*0.22*	*0.39*	*0.20*
of which: prices of food, beverages and tobacco	0.8	-0.2	-0.2	0.1	0.4	0.6	-1.7	-1.0	0.6	0.7	1.6	0.8
(contribution to consumer price inflation)	*0.22*	*-0.05*	*-0.05*	*0.04*	*0.10*	*0.16*	*-0.44*	*-0.25*	*0.16*	*0.18*	*0.42*	*0.22*
adjusted inflation	0.6	0.3	-0.1	-0.1	-0.3	-0.2	0.9	0.3	-1.2	0.1	-0.1	0.0
(contribution to consumer price inflation)	*0.33*	*0.18*	*-0.07*	*-0.06*	*-0.14*	*-0.11*	*0.47*	*0.15*	*-0.65*	*0.03*	*-0.03*	*-0.02*
2004												
Consumer prices	1.8	0.2	0.1	0.0	0.4	0.2	0.4	0.0	-0.8	0.5	-0.1	0.1
Regulated prices	3.7	0.2	0.0	-0.5	-0.7	0.0	0.0	-0.1	0.0	1.6	0.0	0.0
(contribution to consumer price inflation)	*0.76*	*0.04*	*0.01*	*-0.10*	*-0.15*	*0.00*	*0.00*	*-0.03*	*0.01*	*0.34*	*-0.01*	*0.00*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.35*	*0.00*	*0.00*	*0.04*	*0.23*	*0.07*	*0.04*	*0.01*	*0.03*	*0.00*	*0.00*	*0.00*
Net inflation	0.9	0.1	0.1	0.0	0.5	0.1	0.4	0.0	-1.0	0.2	0.0	0.2
(contribution to consumer price inflation)	*0.74*	*0.09*	*0.10*	*0.03*	*0.37*	*0.12*	*0.33*	*-0.01*	*-0.78*	*0.12*	*-0.04*	*0.12*
of which: prices of food, beverages and tobacco	1.0	-0.2	0.1	0.3	0.5	-0.1	-0.6	-0.6	-0.6	0.0	0.0	1.1
(contribution to consumer price inflation)	*0.26*	*-0.05*	*0.02*	*0.07*	*0.14*	*-0.03*	*-0.15*	*-0.15*	*-0.16*	*-0.01*	*0.01*	*0.28*
adjusted inflation	0.9	0.3	0.1	-0.1	0.4	0.3	0.9	0.3	-1.2	0.2	-0.1	-0.3
(contribution to consumer price inflation)	*0.48*	*0.14*	*0.08*	*-0.04*	*0.23*	*0.14*	*0.48*	*0.14*	*-0.63*	*0.13*	*-0.05*	*-0.16*
2005												
Consumer prices	0.7	0.2	-0.1	0.1	0.2	0.6	0.3	0.0	-0.3	0.9	-0.3	-0.1
Regulated prices	2.2	0.2	0.1	-0.2	0.1	1.8	0.8	0.0	0.0	3.7	0.0	0.0
(contribution to consumer price inflation)	*0.48*	*0.04*	*0.01*	*-0.05*	*0.02*	*0.39*	*0.16*	*0.00*	*0.01*	*0.78*	*0.00*	*0.00*
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*-0.06*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.05*
Net inflation	0.3	0.2	-0.1	0.1	0.2	0.2	0.2	0.0	-0.3	0.1	-0.2	-0.3
(contribution to consumer price inflation)	*0.26*	*0.13*	*-0.06*	*0.11*	*0.15*	*0.19*	*0.17*	*-0.01*	*-0.26*	*0.05*	*-0.20*	*-0.20*
of which: prices of food, beverages and tobacco	0.5	0.0	-0.1	-0.2	0.5	0.2	-1.3	-0.7	-0.2	0.4	0.1	0.1
(contribution to consumer price inflation)	*0.12*	*0.01*	*-0.02*	*-0.06*	*0.12*	*0.05*	*-0.33*	*-0.17*	*-0.04*	*0.11*	*0.02*	*0.03*
adjusted inflation	0.3	0.2	-0.1	0.3	0.1	0.3	0.9	0.3	-0.4	-0.1	-0.4	-0.4
(contribution to consumer price inflation)	*0.14*	*0.11*	*-0.04*	*0.17*	*0.03*	*0.14*	*0.50*	*0.16*	*-0.21*	*-0.06*	*-0.22*	*-0.23*
2006												
Consumer prices	1.4	0.1	-0.1	0.1	0.5	0.3						
Regulated prices	4.1	0.2	0.2	0.1	0.9	0.1						
(contribution to consumer price inflation)	*0.89*	*0.04*	*0.03*	*0.02*	*0.21*	*0.02*						
Influence of indirect tax growth on unregulated prices												
(contribution to consumer price inflation)	*0.16*	*0.13*	*0.05*	*0.00*	*0.00*	*0.00*						
Net inflation	0.4	-0.1	-0.3	0.2	0.4	0.3						
(contribution to consumer price inflation)	*0.33*	*-0.05*	*-0.21*	*0.12*	*0.28*	*0.20*						
of which: prices of food, beverages and tobacco	0.2	-0.6	-0.3	0.1	0.7	0.9						
(contribution to consumer price inflation)	*0.04*	*-0.15*	*-0.08*	*0.02*	*0.17*	*0.23*						
adjusted inflation	0.5	0.2	-0.2	0.2	0.2	-0.1						
(contribution to consumer price inflation)	*0.29*	*0.10*	*-0.12*	*0.10*	*0.12*	*-0.03*						

CNB calculation based on CZSO data

Table 2

CONSUMER PRICES percentage changes; December 1999 = 100

Group	Constant 1999 weights in per mille	Months 1	2	3	4	5	6	7	8	9	10	11	12	Average since start of year
Total - 2002	1,000.0	10.0	10.2	10.1	10.0	9.9	9.6	10.1	9.9	9.3	9.0	8.8	9.0	9.7
Total - 2003	1,000.0	9.6	9.8	9.7	9.9	9.9	9.9	10.0	9.8	9.3	9.4	9.9	10.1	9.8
Food and non-alcoholic beverages	197.6	3.1	2.8	2.5	2.7	3.2	4.2	1.7	0.3	1.1	2.2	4.4	5.7	2.8
Alcoholic beverages and tobacco	79.2	7.6	7.7	7.7	7.7	7.9	7.6	7.7	7.7	7.9	7.7	8.0	7.8	7.8
Clothing and footwear	56.9	-9.1	-10.0	-10.4	-10.1	-10.1	-10.4	-11.5	-12.6	-12.4	-12.1	-11.9	-11.9	-11.0
Housing, water, electricity, gas and other fuels	236.4	24.9	25.3	25.4	26.5	26.6	26.6	26.9	27.0	27.0	26.6	26.6	26.6	26.3
Furnishings, household equipment and routine maintenance of the house	67.9	-1.1	-1.2	-1.4	-1.6	-1.8	-2.1	-2.3	-2.6	-2.7	-2.8	-3.0	-3.0	-2.1
Health	14.3	13.7	14.2	14.8	15.4	16.3	16.4	17.4	17.5	17.5	16.9	16.3	16.4	16.1
Transport	101.4	4.7	5.2	5.8	5.5	4.5	3.8	3.5	3.8	4.3	4.0	3.7	3.6	4.4
Communications	22.5	7.9	8.9	8.8	9.0	7.5	7.4	7.4	7.4	7.3	7.3	7.3	7.2	7.8
Recreation and culture	95.5	8.5	9.6	8.5	7.7	7.1	7.0	12.5	14.3	6.1	6.3	6.2	6.1	8.3
Education	4.5	11.3	11.4	11.5	11.5	11.5	11.6	11.6	11.6	11.0	12.0	12.0	12.0	11.6
Hotels, cafés and restaurants	74.2	9.2	9.4	9.4	9.5	9.6	9.6	9.9	10.0	10.3	10.5	10.7	10.8	9.9
Miscellaneous goods and services	49.5	14.0	14.6	14.7	14.7	14.6	14.6	14.5	14.7	14.9	15.4	15.3	15.2	14.8
Total - 2004	1,000.0	12.1	12.3	12.4	12.4	12.9	13.1	13.5	13.5	12.6	13.2	13.1	13.2	12.9
Food and non-alcoholic beverages	197.6	7.4	7.1	7.2	7.5	7.1	7.1	6.3	5.4	4.7	4.7	4.8	6.6	6.3
Alcoholic beverages and tobacco	79.2	8.5	8.6	8.7	9.4	11.2	11.8	12.2	12.4	12.3	12.2	12.1	11.6	10.9
Clothing and footwear	56.9	-13.5	-14.3	-14.3	-14.2	-14.1	-14.1	-15.3	-16.1	-15.8	-14.8	-14.6	-14.6	-14.6
Housing, water, electricity, gas and other fuels	236.4	30.1	30.5	30.7	30.2	29.7	29.8	30.2	30.3	30.5	32.2	32.2	32.2	30.7
Furnishings, household equipment and routine maintenance of the house	67.9	-3.1	-3.3	-3.4	-3.4	-3.9	-3.9	-4.2	-4.4	-4.5	-4.6	-4.8	-4.9	-4.0
Health	14.3	16.5	17.0	17.4	17.9	20.3	20.7	20.9	21.2	21.7	21.0	20.6	20.6	19.7
Transport	101.4	5.8	5.8	6.8	6.8	8.2	7.6	7.3	7.2	6.4	7.0	6.6	5.0	6.7
Communications	22.5	24.2	23.1	23.0	22.9	21.5	21.4	21.3	19.7	19.6	21.2	21.1	21.0	21.7
Recreation and culture	95.5	7.4	8.7	7.6	7.0	7.5	9.1	14.9	17.0	8.9	8.4	8.0	7.9	9.4
Education	4.5	12.2	12.6	12.5	12.5	12.9	12.8	12.8	12.8	17.9	18.1	18.1	18.1	14.4
Hotels, cafés and restaurants	74.2	11.8	12.0	12.4	12.6	17.1	17.5	17.7	17.8	18.8	19.3	19.5	19.6	16.3
Miscellaneous goods and services	49.5	17.4	18.3	18.8	18.7	19.9	20.3	20.4	20.3	20.2	20.1	20.3	20.3	19.6
Total - 2005	1,000.0	14.0	14.2	14.1	14.2	14.4	15.1	15.4	15.4	15.1	16.1	15.8	15.7	15.0
Food and non-alcoholic beverages	197.6	6.9	6.9	6.8	6.6	7.3	7.5	5.6	4.6	4.4	5.0	5.2	5.6	6.0
Alcoholic beverages and tobacco	79.2	12.6	12.8	12.7	12.3	12.3	12.5	12.4	12.4	12.3	12.4	12.3	12.4	12.5
Clothing and footwear	56.9	-17.2	-18.2	-18.4	-18.1	-18.1	-18.3	-19.6	-20.7	-20.6	-20.1	-20.0	-20.2	-19.1
Housing, water, electricity, gas and other fuels	236.4	34.7	34.9	35.1	34.9	34.9	35.0	35.6	35.7	35.8	38.9	38.9	38.9	36.1
Furnishings, household equipment and routine maintenance of the house	67.9	-5.2	-5.4	-5.5	-5.7	-5.8	-5.9	-6.1	-6.2	-6.4	-6.4	-6.5	-6.6	-6.0
Health	14.3	25.5	26.1	26.7	27.3	29.1	30.1	30.2	30.4	31.0	29.9	29.5	29.5	28.8
Transport	101.4	3.9	3.7	4.1	6.8	6.9	7.8	9.5	9.6	13.6	13.0	11.1	8.8	8.2
Communications	22.5	21.0	20.1	20.1	20.0	19.9	38.6	39.0	39.0	38.2	38.2	38.1	38.1	30.9
Recreation and culture	95.5	9.8	11.4	10.1	8.9	9.4	10.1	15.8	18.1	10.1	11.2	10.6	10.5	11.3
Education	4.5	14.9	15.6	15.8	15.8	15.8	15.6	15.6	15.6	19.5	20.2	20.2	20.2	17.1
Hotels, cafés and restaurants	74.2	20.4	21.0	21.2	21.5	21.4	21.5	21.2	21.2	22.4	22.8	22.8	22.8	21.7
Miscellaneous goods and services	49.5	20.3	20.9	20.9	20.9	20.8	20.7	20.7	20.6	20.7	20.8	20.9	20.9	20.8
Total - 2006	1,000.0	17.3	17.4	17.3	17.4	18.0	18.3							17.6
Food and non-alcoholic beverages	197.6	6.4	6.2	6.0	6.2	7.0	8.5							6.7
Alcoholic beverages and tobacco	79.2	13.5	13.7	13.7	13.5	14.0	13.7							13.7
Clothing and footwear	56.9	-22.1	-23.0	-23.2	-23.1	-23.2	-23.6							-23.0
Housing, water, electricity, gas and other fuels	236.4	44.1	44.4	44.5	44.8	44.9	45.0							44.6
Furnishings, household equipment and routine maintenance of the house	67.9	-6.8	-6.8	-7.0	-7.0	-7.1	-7.3							-7.0
Health	14.3	30.9	31.3	32.3	32.8	34.1	34.9							32.7
Transport	101.4	8.5	8.7	8.5	10.1	11.4	11.3							9.8
Communications	22.5	38.8	36.0	36.0	33.1	40.5	40.5							37.5
Recreation and culture	95.5	12.0	13.3	12.1	11.4	11.7	11.6							12.0
Education	4.5	20.1	20.2	20.1	20.1	20.1	20.1							20.1
Hotels, cafés and restaurants	74.2	23.6	24.0	24.1	24.4	24.6	24.8							24.3
Miscellaneous goods and services	49.5	21.9	22.5	22.7	22.9	23.0	22.9							22.7

Source: CZSO

Table 3

CONSUMER PRICES - TRADABLES AND NONTRADABLES

percentage changes; December 1999 = 100

Group	Constant 1999 weights in per mille	2002 12	2003 12	2004 12	2005 6	2005 9	2005 12	2006 3	2006 6
1. Food and non-alcoholic beverages	197.6	2.1	5.7	6.6	7.5	4.4	5.6	6.0	8.5
- tradables	197.6	2.1	5.7	6.6	7.5	4.4	5.6	6.0	8.5
2. Alcoholic beverages and tobacco	79.2	7.1	7.8	11.6	12.5	12.3	12.4	13.7	13.7
- tradables	79.2	7.1	7.8	11.6	12.5	12.3	12.4	13.7	13.7
3. Clothing and footwear	56.9	-7.7	-11.9	-14.6	-18.3	-20.6	-20.2	-23.2	-23.6
- nontradables	1.4	18.3	21.1	35.9	37.1	37.6	38.4	40.8	41.8
- tradables	55.5	-8.4	-12.7	-15.9	-19.7	-22.1	-21.7	-24.8	-25.3
4. Housing, water, electricity, gas and other fuels	236.4	24.3	26.6	32.2	35.0	35.8	38.9	44.5	45.0
- nontradables	226.1	25.2	27.5	33.2	36.1	36.9	40.1	45.9	46.5
- tradables	10.3	4.0	5.9	10.7	10.6	12.0	12.4	12.6	11.6
5. Furnishings, household equipment and routine maintenance of the house	67.9	-1.0	-3.0	-4.9	-5.9	-6.4	-6.6	-7.0	-7.3
- nontradables	2.9	9.9	12.3	16.8	16.5	17.1	17.3	19.0	20.0
- tradables	65.0	-1.5	-3.7	-5.9	-6.9	-7.5	-7.7	-8.2	-8.5
6. Health	14.3	12.8	16.4	20.6	30.1	31.0	29.5	32.3	34.9
- nontradables	11.0	15.4	19.9	25.2	37.4	38.5	36.5	40.0	43.3
- tradables	3.3	4.4	5.1	5.6	6.4	6.4	6.7	7.1	7.4
7. Transport	101.4	4.1	3.6	5.0	7.8	13.6	8.8	8.5	11.3
- nontradables	27.4	16.0	18.4	23.0	24.7	26.3	26.8	28.6	28.9
- tradables	74.0	-0.3	-1.9	-1.6	1.5	8.9	2.1	1.1	4.8
8. Communications	22.5	8.2	7.2	21.0	38.6	38.2	38.1	36.0	40.5
- nontradables	21.0	2.1	12.1	32.8	46.5	46.5	46.5	46.5	53.9
- tradables	1.5	95.9	-62.3	-92.6	-94.6	-80.8	-82.3	-85.8	-94.9
9. Recreation and culture	95.5	7.2	6.1	7.9	10.1	10.1	10.5	12.1	11.6
- nontradables	60.4	16.2	16.7	21.2	26.2	26.8	27.4	30.0	30.0
- tradables	35.1	-8.3	-12.1	-15.0	-17.7	-18.7	-18.6	-18.7	-20.0
10. Education	4.5	11.3	12.0	18.1	15.6	19.5	20.2	20.1	20.1
- nontradables	4.5	11.3	12.0	18.1	15.6	19.5	20.2	20.1	20.1
11. Hotels, cafés and restaurants	74.2	8.7	10.8	19.6	21.5	22.4	22.8	24.1	24.8
- nontradables	74.2	8.7	10.8	19.6	21.5	22.4	22.8	24.1	24.8
12. Miscellaneous goods and services	49.5	11.9	15.2	20.3	20.7	20.7	20.9	22.7	22.9
- nontradables	22.0	25.8	36.4	48.4	50.7	51.2	51.5	55.4	56.0
- tradables	27.5	0.8	-1.7	-2.2	-3.2	-3.6	-3.5	-3.4	-3.5
Household consumer prices, total	1,000.0	9.0	10.1	13.2	15.0	15.1	15.7	17.3	18.3
Tradables	549.1	0.6	0.3	0.3	0.6	0.1	-0.3	-0.6	0.5
- food	276.8	3.5	6.3	8.0	8.9	6.7	7.5	8.2	10.0
- others	272.3	-2.4	-5.8	-7.6	-7.8	-6.5	-8.3	-9.5	-9.1
Nontradables	450.9	19.2	22.0	29.0	32.6	33.4	35.2	39.1	39.9
- others	271.2	16.5	19.4	29.9	32.5	33.1	32.8	35.1	35.5
- regulated	179.7	23.2	26.0	27.7	32.7	33.8	38.8	45.0	46.7

CNB calculation based on CZSO data

Table 4

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

		CPI	
	Financial market	Businesses	Households
1/02	3.8	—	—
2/02	3.5	—	—
3/02	3.5	3.6	3.9
4/02	3.5	—	—
5/02	3.3	—	—
6/02	3.1	2.7	1.6
7/02	2.8	—	—
8/02	2.7	—	—
9/02	3.1	2.4	1.3
10/02	2.5	—	—
11/02	2.4	—	—
12/02	2.3	2.3	2.3
1/03	2.5	—	—
2/03	2.4	—	—
3/03	2.5	2.1	4.3
4/03	2.6	—	—
5/03	3.7	—	—
6/03	3.2	2.6	1.7
7/03	3.3	—	—
8/03	3.2	—	—
9/03	3.1	2.6	3.1
10/03	3.0	—	—
11/03	3.1	—	—
12/03	3.3	2.9	4.2
1/04	2.9	—	—
2/04	3.2	—	—
3/04	3.0	3.3	4.9
4/04	2.8	—	—
5/04	2.6	—	—
6/04	2.7	3.1	4.9
7/04	2.8	—	—
8/04	2.8	—	—
9/04	3.0	3.1	1.7
10/04	2.8	—	—
11/04	2.8	—	—
12/04	2.8	3.2	1.5
1/05	2.8	—	—
2/05	2.6	—	—
3/05	2.6	2.7	3.8
4/05	2.5	—	—
5/05	2.4	—	—
6/05	2.3	2.7	3.8
7/05	2.4	—	—
8/05	2.5	—	—
9/05	2.5	2.8	5.2
10/05	2.7	—	—
11/05	2.8	—	—
12/05	2.6	2.8	4.6
1/06	2.5	—	—
2/06	2.5	—	—
3/06	2.5	2.7	4.1
4/06	2.6	—	—
5/06	2.6	—	—
6/06	2.8	2.9	5.9

Source: CNB statistical survey

Table 5

HARMONISED INDEX OF CONSUMER PRICES

annual percentage changes

	2002	2003	2004	2005	2006
	12	12	12	12	6
European Union (25 countries)	2.1	1.9	2.4	2.1	2.4
European Union (15 countries)	2.2	1.8	2.2	2.2	2.4
Belgium	1.3	1.7	1.9	2.8	2.5
Czech Republic	0.1	0.9	2.5	1.9	2.3
Denmark	2.6	1.2	0.9	2.2	2.1
Germany	1.2	1.0	2.3	2.1	2.0
Estonia	2.7	1.2	4.8	3.6	4.4
Greece	3.5	3.1	3.1	3.5	3.4
Spain	4.0	2.7	3.3	3.7	4.0
France	2.2	2.4	2.3	1.8	2.2
Ireland	4.6	3.0	2.4	1.9	2.9
Italy	2.9	2.5	2.4	2.1	2.4
Cyprus	3.1	2.2	3.9	1.4	2.6
Latvia	1.5	3.5	7.4	7.1	6.3
Lithuania	-0.9	-1.3	2.8	3.0	3.7
Luxembourg	2.8	2.4	3.5	3.4	3.9
Hungary	4.9	5.6	5.5	3.3	2.9
Malta	2.1	2.4	1.9	3.4	3.3
Netherlands	3.2	1.6	1.2	2.0	1.8
Austria	1.7	1.3	2.5	1.6	1.8
Poland	0.8	1.6	4.4	0.8	1.5
Portugal	4.0	2.3	2.6	2.5	2.8
Slovenia	7.1	4.7	3.3	2.4	3.0
Slovakia	3.2	9.4	5.8	3.9	4.5
Finland	1.7	1.2	0.1	1.1	1.5
Sweden	1.6	1.8	0.9	1.3	1.9
United Kingdom	1.7	1.3	1.7	1.9	

Source: Eurostat

Table 6

MONETARY SURVEY					position at month-end in CZK billions
	2002	2003	2004	2005	2006
	12	12	12	12	5
Total assets	1,651.8	1,766.1	1,844.1	1,992.1	2,063.4
Net external assets (NEAs)	926.1	821.5	863.3	1,076.4	1,019.6
NEAs of CNB	715.6	687.5	634.1	724.7	676.3
NEAs of OMFIs	210.5	134.0	229.3	351.7	343.3
Net domestic assets	725.8	944.5	980.8	915.8	1,043.8
Domestic loans	940.0	1,145.6	1,147.0	1,166.6	1,251.0
Net credit to government (NCG) (including securities)	215.8	354.0	257.5	99.1	97.9
NCG to central government (including securities)	260.4	408.7	312.4	163.0	180.7
NCG to other government (including securities)	-44.6	-54.8	-54.9	-64.0	-82.8
Loans to corporations and households (excluding securities)	724.2	791.6	889.4	1,067.5	1,153.1
Loans to corporations (excluding securities)	542.7	554.1	574.2	649.7	696.6
Loans to households (excluding securities)	181.5	237.5	315.2	417.8	456.6
Other net items (including securities and capital)	-214.3	-201.1	-166.2	-250.8	-207.2
Holdings of securities	18.5	16.6	18.8	14.4	13.8
Issued securities	-48.6	-51.6	-74.9	-119.1	-117.5
Liabilities					
Monetary aggregate M2	1,651.8	1,766.1	1,844.1	1,992.1	2,063.4
Monetary aggregate M1	787.7	902.8	962.3	1,087.3	1,160.0
Currency in circulation	197.8	221.4	236.8	263.8	273.3
Overnight deposits	589.9	681.4	725.6	823.5	886.7
Overnight deposits - households	315.6	372.1	410.8	456.6	502.2
Overnight deposits - corporations	274.3	309.3	314.7	367.0	384.5
M2-M1 (quasi money)	864.1	863.3	881.8	904.8	903.4
Deposits with agreed maturity	651.2	666.4	675.3	671.4	660.8
Deposits with agreed maturity - households	448.6	439.8	458.6	445.1	442.9
Deposits with agreed maturity - corporations	202.5	226.6	216.7	226.3	217.9
Deposits redeemable at notice	194.3	185.6	198.8	224.1	227.9
Deposits redeemable at notice - households	190.7	182.3	194.6	220.6	224.7
Deposits redeemable at notice - corporations	3.6	3.2	4.2	3.6	3.2
Repurchase agreements	18.6	11.3	7.6	9.3	14.8
Annual percentage changes					
M1	35.0	14.6	6.6	13.0	15.1
M2	3.5	6.9	4.4	8.0	7.9
Loans to corporations and households	-6.6	9.3	12.4	20.0	21.3
M2-M1 (deposits)	-14.6	-0.1	2.1	2.6	-0.1
Annual percentage growth rates					
M1	__	15.5	8.3	13.1	15.9
M2	__	8.1	5.8	8.1	8.7
Loans to corporations and households	__	11.8	15.3	20.8	22.5
M2-M1 (deposits)	__	1.2	3.3	2.6	0.7

Table 7

INTEREST RATES ON INTERBANK DEPOSITS

percentages

	2002 12	2003 12	2004 12	2005 12	2006 6
1. Average PRIBOR [1]					
- 1 day	2.75	1.98	2.49	2.00	1.97
- 7 day	2.76	2.02	2.51	2.04	2.03
- 14 day	2.76	2.03	2.51	2.04	2.04
- 1 month	2.73	2.04	2.53	2.05	2.07
- 2 month	2.67	2.06	2.55	2.10	2.11
- 3 month	2.63	2.08	2.57	2.17	2.16
- 6 month	2.60	2.13	2.67	2.33	2.30
- 9 month	2.60	2.22	2.76	2.44	2.43
- 12 month	2.60	2.30	2.85	2.53	2.55
2. Average PRIBID [1]					
- 1 day	2.65	1.88	2.39	1.90	1.87
- 7 day	2.67	1.92	2.41	1.94	1.93
- 14 day	2.67	1.93	2.41	1.94	1.94
- 1 month	2.64	1.94	2.43	1.95	1.97
- 2 month	2.57	1.96	2.45	2.00	2.01
- 3 month	2.54	1.98	2.47	2.07	2.06
- 6 month	2.51	2.03	2.57	2.23	2.20
- 9 month	2.51	2.12	2.66	2.34	2.33
- 12 month	2.51	2.20	2.75	2.43	2.45

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

Table 8

FRA RATES					percentages; monthly averages
	2002	2003	2004	2005	2006
	12	12	12	12	6
3 * 6	2.52	2.23	2.74	2.46	2.44
3 * 9	2.54	2.36	2.81	2.57	2.58
6 * 9	2.52	2.47	2.85	2.66	2.71
6 * 12	2.58	2.64	2.92	2.74	2.85
9 * 12	2.61	2.77	2.97	2.79	2.96
9*12 - 3*6 spread	0.10	0.55	0.24	0.33	0.53
6*12 - 3*9 spread	0.04	0.28	0.12	0.17	0.26

IRS RATES					percentages; monthly averages
	2002	2003	2004	2005	2006
	12	12	12	12	6
1Y	2.63	2.41	2.82	2.56	2.60
2Y	2.85	2.98	3.06	2.82	3.07
3Y	3.18	3.38	3.27	3.00	3.35
4Y	3.46	3.69	3.45	3.13	3.53
5Y	3.70	3.93	3.62	3.25	3.66
6Y	3.91	4.13	3.77	3.33	3.76
7Y	4.08	4.29	3.89	3.40	3.84
8Y	4.23	4.43	4.00	3.46	3.92
9Y	4.36	4.54	4.09	3.52	3.99
10Y	4.47	4.64	4.17	3.58	4.04
15Y	4.77	4.97	4.40	3.78	4.26
20Y	—	5.11	4.54	3.88	4.38
5Y - 1Y spread	1.07	1.52	0.80	0.69	1.05
10Y - 1Y spread	1.84	2.23	1.35	1.02	1.44

Table 9

NOMINAL AND REAL INTEREST RATES (ex post approach)

percentages

	Nominal rates				Real rates based on CPI				Real rates based on PPI		
	PRIBOR		client rates		PRIBOR		client rates		PRIBOR		new
	2W	1Y	new loans	time deposits	2W	1Y	new loans	time deposits	2W	1Y	client loans
1/02	4.7	4.5	5.7	3.2	1.0	0.8	2.0	-0.4	4.1	3.9	5.1
2/02	4.3	4.4	5.1	3.0	0.4	0.5	1.1	-0.8	4.4	4.5	5.2
3/02	4.3	4.5	5.3	3.0	0.6	0.8	1.6	-0.7	4.5	4.7	5.5
4/02	4.2	4.4	5.1	2.9	1.0	1.1	1.8	-0.2	4.3	4.5	5.2
5/02	3.8	4.1	4.9	2.8	1.3	1.5	2.3	0.3	4.3	4.6	5.4
6/02	3.8	3.9	5.0	2.9	2.6	2.7	3.8	1.7	4.6	4.8	5.9
7/02	3.5	3.4	4.5	2.8	2.9	2.8	3.9	2.2	4.7	4.6	5.7
8/02	3.0	3.1	4.4	2.3	2.4	2.5	3.8	1.7	4.0	4.1	5.4
9/02	3.0	3.0	4.5	2.5	2.2	2.1	3.7	1.7	4.0	3.9	5.5
10/02	3.0	2.8	4.6	2.3	2.4	2.2	4.0	1.7	3.9	3.7	5.5
11/02	2.8	2.8	4.2	2.1	2.3	2.2	3.7	1.6	3.5	3.5	4.9
12/02	2.8	2.6	4.2	2.2	2.1	2.0	3.6	1.6	3.5	3.3	4.9
1/03	2.7	2.6	4.1	2.2	3.2	3.0	4.5	2.6	3.6	3.5	5.0
2/03	2.5	2.4	3.9	2.1	2.9	2.8	4.3	2.5	3.2	3.2	4.6
3/03	2.5	2.4	3.9	2.0	2.9	2.8	4.3	2.5	2.9	2.8	4.3
4/03	2.5	2.4	3.9	2.0	2.6	2.5	4.0	2.1	3.2	3.2	4.7
5/03	2.5	2.4	4.0	2.0	2.5	2.4	4.0	2.0	3.3	3.3	4.8
6/03	2.5	2.3	3.8	1.9	2.2	2.0	3.5	1.6	3.4	3.2	4.8
7/03	2.3	2.2	3.5	1.7	2.4	2.3	3.6	1.8	2.9	2.9	4.2
8/03	2.0	2.1	3.3	1.8	2.1	2.2	3.4	1.9	2.4	2.5	3.7
9/03	2.0	2.2	3.6	1.7	2.0	2.2	3.6	1.7	2.0	2.2	3.6
10/03	2.0	2.2	3.7	1.7	1.6	1.8	3.3	1.3	2.1	2.3	3.8
11/03	2.0	2.2	3.5	1.8	1.0	1.2	2.5	0.7	1.6	1.8	3.1
12/03	2.0	2.3	3.7	1.7	1.0	1.3	2.6	0.7	1.1	1.4	2.7
1/04	2.0	2.3	5.5	1.4	-0.3	0.0	3.1	-0.9	0.4	0.7	3.9
2/04	2.0	2.3	5.0	1.4	-0.3	0.0	2.7	-0.9	0.5	0.8	3.5
3/04	2.0	2.3	5.1	1.5	-0.5	-0.2	2.6	-1.0	-0.1	0.2	3.0
4/04	2.0	2.3	5.4	1.5	-0.3	0.0	3.0	-0.8	-1.6	-1.4	1.6
5/04	2.0	2.5	5.4	1.5	-0.7	-0.2	2.6	-1.2	-2.7	-2.3	0.5
6/04	2.1	2.8	5.3	1.6	-0.8	-0.1	2.4	-1.3	-3.9	-3.2	-0.8
7/04	2.3	3.0	5.7	1.7	-0.9	-0.2	2.4	-1.5	-4.7	-4.0	-1.5
8/04	2.3	3.0	6.0	1.7	-1.0	-0.4	2.5	-1.7	-5.3	-4.7	-1.9
9/04	2.5	3.1	5.9	1.8	-0.5	0.1	2.9	-1.2	-5.1	-4.5	-1.9
10/04	2.5	3.0	6.0	1.8	-1.0	-0.4	2.4	-1.6	-5.6	-5.1	-2.4
11/04	2.5	2.9	6.1	1.8	-0.4	0.0	3.1	-1.1	-5.3	-4.9	-2.0
12/04	2.5	2.8	6.1	1.9	-0.3	0.0	3.2	-0.9	-4.8	-4.5	-1.5
1/05	2.5	2.7	6.2	1.8	0.8	1.0	4.4	0.1	-4.4	-4.2	-1.0
2/05	2.3	2.2	6.0	1.7	0.6	0.5	4.2	0.0	-4.5	-4.5	-1.1
3/05	2.2	2.1	5.6	1.7	0.7	0.6	4.1	0.2	-3.9	-4.0	-0.7
4/05	2.0	2.1	5.9	1.6	0.4	0.4	4.2	0.0	-3.4	-3.4	0.2
5/05	1.8	1.8	5.7	1.4	0.5	0.5	4.3	0.1	-2.1	-2.1	1.6
6/05	1.8	1.8	5.3	1.4	0.0	0.0	3.4	-0.4	-0.9	-0.9	2.5
7/05	1.8	1.8	5.3	1.4	0.1	0.1	3.6	-0.3	-0.2	-0.2	3.3
8/05	1.8	1.9	5.3	1.4	0.1	0.2	3.5	-0.3	0.7	0.8	4.1
9/05	1.8	1.9	5.1	1.5	-0.4	-0.3	2.8	-0.7	0.8	0.9	4.1
10/05	1.8	2.2	5.6	1.5	-0.8	-0.4	2.9	-1.1	1.5	1.9	5.3
11/05	2.0	2.6	5.4	1.7	-0.4	0.2	2.9	-0.7	2.0	2.6	5.4
12/05	2.0	2.5	5.5	1.7	-0.2	0.3	3.2	-0.5	2.3	2.8	5.8
1/06	2.0	2.4	5.5	1.7	-0.8	-0.5	2.6	-1.2	1.7	2.1	5.2
2/06	2.0	2.2	5.5	1.7	-0.8	-0.6	2.6	-1.1	1.7	1.9	5.2
3/06	2.0	2.3	5.5	1.7	-0.8	-0.5	2.6	-1.1	1.7	2.0	5.2
4/06	2.0	2.4	5.6	1.7	-0.8	-0.4	2.7	-1.0	1.5	1.9	5.1
5/06	2.0	2.4	5.6	1.7	-1.0	-0.6	2.4	-1.3	0.5	0.9	4.0
6/06	2.0	2.6	—	—	-0.7	-0.2	—	—	0.2	0.7	—

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

Table 10

REAL INTEREST RATES (ex ante approach)

percentages

	Real rates expected by financial markets				Real rates expected by businesses				Real rates expected by households			
	PRIBOR		client rates		PRIBOR		client rates		PRIBOR		client rates	
	2W	1Y	new loans	time deposits	2W	1Y	new loans	time deposits	2W	1Y	new loans	time deposits
1/02	0.9	0.7	1.9	-0.5	—	—	—	—	—	—	—	—
2/02	0.8	0.8	1.5	-0.4	—	—	—	—	—	—	—	—
3/02	0.8	1.0	1.8	-0.5	0.7	0.9	1.7	-0.6	0.4	0.6	1.4	-0.9
4/02	0.7	0.8	1.5	-0.5	—	—	—	—	—	—	—	—
5/02	0.5	0.7	1.5	-0.5	—	—	—	—	—	—	—	—
6/02	0.7	0.8	1.9	-0.2	1.1	1.2	2.3	0.2	2.2	2.3	3.4	1.3
7/02	0.7	0.6	1.7	0.0	—	—	—	—	—	—	—	—
8/02	0.3	0.4	1.7	-0.4	—	—	—	—	—	—	—	—
9/02	-0.1	-0.1	1.4	-0.6	1.1	1.0	2.6	0.6	1.7	1.6	3.2	1.2
10/02	0.5	0.3	2.0	-0.2	—	—	—	—	—	—	—	—
11/02	0.4	0.3	1.8	-0.3	—	—	—	—	—	—	—	—
12/02	0.5	0.3	1.9	-0.1	0.5	0.3	1.9	-0.1	0.5	0.3	1.9	-0.1
1/03	0.2	0.1	1.6	-0.3	—	—	—	—	—	—	—	—
2/03	0.1	0.0	1.4	-0.3	—	—	—	—	—	—	—	—
3/03	0.0	-0.1	1.3	-0.4	0.4	0.3	1.7	-0.1	-1.7	-1.9	-0.4	-2.2
4/03	-0.1	-0.2	1.3	-0.6	—	—	—	—	—	—	—	—
5/03	-1.2	-1.2	0.3	-1.6	—	—	—	—	—	—	—	—
6/03	-0.7	-0.9	0.6	-1.2	-0.1	-0.3	1.2	-0.6	0.8	0.6	2.1	0.2
7/03	-1.0	-1.0	0.2	-1.5	—	—	—	—	—	—	—	—
8/03	-1.1	-1.1	0.1	-1.4	—	—	—	—	—	—	—	—
9/03	-1.0	-0.9	0.5	-1.3	-0.6	-0.4	1.0	-0.8	-1.0	-0.9	0.5	-1.3
10/03	-0.9	-0.8	0.6	-1.2	—	—	—	—	—	—	—	—
11/03	-1.0	-0.8	0.4	-1.3	—	—	—	—	—	—	—	—
12/03	-1.2	-1.0	0.4	-1.5	-0.8	-0.6	0.7	-1.1	-2.1	-1.8	-0.5	-2.4
1/04	-0.9	-0.6	2.5	-1.4	—	—	—	—	—	—	—	—
2/04	-1.2	-0.8	1.8	-1.7	—	—	—	—	—	—	—	—
3/04	-1.0	-0.7	2.1	-1.5	-1.2	-1.0	1.8	-1.8	-2.8	-2.5	0.2	-3.3
4/04	-0.8	-0.5	2.5	-1.3	—	—	—	—	—	—	—	—
5/04	-0.6	-0.1	2.7	-1.1	—	—	—	—	—	—	—	—
6/04	-0.6	0.1	2.6	-1.1	-1.0	-0.3	2.2	-1.5	-2.7	-2.0	0.4	-3.2
7/04	-0.5	0.2	2.8	-1.1	—	—	—	—	—	—	—	—
8/04	-0.5	0.2	3.1	-1.1	—	—	—	—	—	—	—	—
9/04	-0.5	0.1	2.9	-1.2	-0.6	0.0	2.8	-1.3	0.8	1.4	4.2	0.1
10/04	-0.3	0.2	3.1	-1.0	—	—	—	—	—	—	—	—
11/04	-0.3	0.1	3.2	-1.0	—	—	—	—	—	—	—	—
12/04	-0.3	0.0	3.2	-0.9	-0.7	-0.3	2.8	-1.3	1.0	1.3	4.5	0.3
1/05	-0.3	-0.1	3.3	-0.9	—	—	—	—	—	—	—	—
2/05	-0.3	-0.3	3.3	-0.8	—	—	—	—	—	—	—	—
3/05	-0.4	-0.5	2.9	-0.9	-0.5	-0.6	2.8	-1.0	-1.5	-1.6	1.8	-2.0
4/05	-0.5	-0.4	3.3	-0.9	—	—	—	—	—	—	—	—
5/05	-0.6	-0.6	3.2	-0.9	—	—	—	—	—	—	—	—
6/05	-0.5	-0.5	2.9	-0.8	-0.9	-0.9	2.5	-1.2	-2.0	-2.0	1.4	-2.3
7/05	-0.6	-0.6	2.9	-0.9	—	—	—	—	—	—	—	—
8/05	-0.7	-0.6	2.7	-1.0	—	—	—	—	—	—	—	—
9/05	-0.7	-0.6	2.5	-1.0	-1.0	-0.9	2.2	-1.3	-3.3	-3.2	-0.1	-3.6
10/05	-0.9	-0.5	2.8	-1.1	—	—	—	—	—	—	—	—
11/05	-0.7	-0.2	2.5	-1.1	—	—	—	—	—	—	—	—
12/05	-0.5	-0.1	2.8	-0.9	-0.8	-0.3	2.6	-1.1	-2.5	-2.0	0.8	-2.8
1/06	-0.5	-0.1	3.0	-0.8	—	—	—	—	—	—	—	—
2/06	-0.5	-0.3	2.9	-0.8	—	—	—	—	—	—	—	—
3/06	-0.5	-0.2	2.9	-0.8	-0.7	-0.4	2.7	-1.0	-2.0	-1.7	1.4	-2.3
4/06	-0.6	-0.2	2.9	-0.9	—	—	—	—	—	—	—	—
5/06	-0.6	-0.2	2.9	-0.9	—	—	—	—	—	—	—	—
6/06	-0.7	-0.2	—	—	-0.8	-0.3	—	—	-3.6	-3.2	—	—

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

Table 11

KORUNA INTEREST RATES (stock of business)

percentages

	2002 12	2003 12	2004 12	2005 12	2006 5
Koruna interest rates on loans provided by banks to residents:					
Households and non-profit institutions serving households (S.14+S.15) - total	8.77	8.24	7.96	7.20	6.95
- maturity up to 1 year	10.35	11.21	12.82	12.96	12.98
- maturity over 1 year and up to 5 years	10.80	10.17	12.40	11.43	11.28
- maturity over 5 years	7.35	6.65	6.39	5.96	5.88
for consumption - total	13.83	13.83	14.89	13.88	13.58
- maturity up to 1 year	13.05	14.26	15.48	16.22	16.51
- maturity over 1 year and up to 5 years	14.48	13.86	15.17	14.94	14.81
- maturity over 5 years	12.55	13.21	13.45	11.85	11.75
for house purchase - total	7.11	6.31	5.93	5.24	5.06
- maturity up to 1 year	7.67	6.24	4.48	4.29	4.60
- maturity over 1 year and up to 5 years	7.90	7.05	6.57	6.22	6.18
- maturity over 5 years	6.88	6.09	5.89	5.19	5.02
other - total	6.99	7.80	7.50	7.09	6.90
- maturity up to 1 year	6.64	8.49	8.96	9.09	9.06
- maturity over 1 year and up to 5 years	6.34	8.02	7.63	7.17	7.27
- maturity over 5 years	7.61	7.02	6.58	5.79	5.56
Non-financial corporations (S.11) - total	5.19	4.53	4.75	4.20	4.19
- maturity up to 1 year	4.34	4.08	4.35	3.84	3.92
- maturity over 1 year and up to 5 years	5.47	4.64	4.68	4.18	4.12
- maturity over 5 years	6.34	5.14	5.39	4.72	4.58
Koruna interest rates on deposits accepted by banks from residents:					
Households and non-profit institutions serving households (S.14+S.15) - total	1.72	1.30	1.41	1.25	1.20
overnight	0.94	0.50	0.52	0.40	0.38
with agreed maturity - total	2.26	2.02	2.13	1.92	1.89
- with agreed maturity up to 2 years	1.68	0.96	1.37	1.03	1.05
- with agreed maturity over 2 years	3.04	2.90	2.69	2.50	2.43
redeemable at notice - total	1.81	1.26	1.63	1.71	1.76
- redeemable at notice up to 3 months	1.93	1.67	2.14	2.27	2.20
- redeemable at notice over 3 months	1.73	0.98	1.12	0.81	0.82
Non-financial corporations (S.11) - total	1.25	0.85	1.21	0.91	1.05
overnight	0.94	0.64	0.68	0.52	0.73
with agreed maturity - total	2.16	1.50	2.08	1.64	1.64
- with agreed maturity up to 2 years	2.15	1.49	2.05	1.61	1.61
- with agreed maturity over 2 years	3.47	3.04	3.12	2.47	2.45
redeemable at notice - total	1.64	1.17	1.60	1.14	1.14
- redeemable at notice up to 3 months	1.60	1.14	1.49	1.07	1.08
- redeemable at notice over 3 months	2.26	1.32	2.26	1.64	1.64

Table 12

BALANCE OF PAYMENTS [1]					in CZK millions
	2002	2003	2004	2005 [2]	2006 [2]
	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q1
A. Current account	-136,378.1	-160,614.6	-167,348.2	-61,670.2	228.7
Balance of trade [3]	-71,323.0	-69,793.0	-26,438.0	40,354.0	25,492.0
exports	1,254,394.0	1,370,930.0	1,722,657.0	1,875,219.0	509,815.0
imports	1,325,717.0	1,440,723.0	1,749,095.0	1,834,865.0	484,323.0
Services	21,850.8	13,236.7	12,539.3	19,411.8	821.0
credit	231,131.1	219,151.1	248,535.1	257,998.4	56,693.3
transport	56,560.5	60,556.3	72,308.9	78,763.0	18,216.1
travel	96,289.2	100,310.1	107,231.8	110,948.0	22,825.6
others	78,281.4	58,284.7	68,994.4	68,287.4	15,651.6
debit	209,280.3	205,914.4	235,995.8	238,586.6	55,872.3
transport	29,332.8	33,725.7	38,603.0	43,135.9	9,771.4
travel	51,549.3	54,419.2	58,398.0	57,777.6	11,241.4
others	128,398.2	117,769.5	138,994.8	137,673.1	34,859.5
Income	-115,615.0	-119,858.4	-157,772.9	-142,318.3	-26,544.7
credit	66,790.1	75,508.3	87,040.1	112,322.7	30,141.2
debit	182,405.1	195,366.7	244,813.0	254,641.0	56,685.9
Current transfers	28,709.1	15,800.1	4,323.4	20,882.3	460.4
credit	46,709.0	46,976.7	46,777.3	75,639.7	19,919.5
debit	17,999.9	31,176.6	42,453.9	54,757.4	19,459.1
B. Capital account	-119.4	-82.2	-14,017.0	5,059.2	2,695.3
credit	221.0	198.2	5,608.2	5,731.1	3,092.0
debit	340.4	280.4	19,625.2	671.9	396.7
Total A + B	*-136,497.5*	*-160,696.8*	*-181,365.2*	*-56,611.0*	*2,924.0*
C. Financial account	347,827.4	157,093.5	183,659.9	137,925.6	-1,477.0
Direct investment	270,930.2	53,500.3	101,776.3	242,706.1	18,935.2
abroad	-6,759.3	-5,815.7	-26,067.3	-20,500.1	-3,752.4
equity capital and reinvested earnings	-5,376.8	-3,124.6	-20,260.0	-11,372.3	-3,058.9
other capital	-1,382.5	-2,691.1	-5,807.3	-9,127.8	-693.5
in the Czech Republic	277,689.5	59,316.0	127,843.6	263,206.2	22,687.6
equity capital and reinvested earnings	270,061.0	59,350.4	121,482.9	262,791.9	22,455.6
other capital	7,628.5	-34.4	6,360.7	414.3	232.0
Portfolio investment	-46,748.7	-35,719.1	59,380.4	-72,002.0	-5,475.2
assets	-75,602.1	-83,892.7	-63,897.3	-72,853.9	-14,599.1
equity securities	-7,807.9	5,630.5	-30,109.2	-26,036.2	-4,164.2
debt securities	-67,794.2	-89,523.2	-33,788.1	-46,817.7	-10,434.9
liabilities	28,853.4	48,173.6	123,277.7	851.9	9,123.9
equity securities	-9,035.7	30,133.5	19,558.6	-36,408.9	861.1
debt securities	37,889.1	18,040.1	103,719.1	37,260.8	8,262.8
Financial derivatives	-4,281.7	3,860.1	-3,208.0	-2,801.8	-1,610.6
assets	-15,458.4	7,083.7	-15,565.8	-1,668.4	-1,798.2
liabilities	11,176.7	-3,223.6	12,357.8	-1,133.4	187.6
Other investment	127,927.6	135,452.2	25,711.2	-29,976.7	-13,326.4
assets	133,121.8	67,071.3	-30,507.4	-104,419.1	21,545.6
long-term	28,711.4	1,141.3	20,434.2	-16,360.9	-4,155.2
CNB	—	—	-184.9	-176.3	—
commercial banks	5,271.7	-999.9	505.0	-24,664.6	-5,409.8
government	25,333.6	5,714.3	22,790.7	14,056.5	1,527.6
other sectors	-1,893.9	-3,573.1	-2,676.6	-5,576.5	-273.0
short-term	104,410.4	65,930.0	-50,941.6	-88,058.2	25,700.8
commercial banks	122,163.8	44,971.2	-34,248.5	-87,102.6	43,952.3
government	-2,237.4	2,193.8	92.9	9.4	0.1
other sectors	-15,516.0	18,765.0	-16,786.0	-965.0	-18,251.6
liabilities	-5,194.2	68,380.9	56,218.6	74,442.4	-34,872.0
long-term	2,853.8	26,361.6	36,550.9	50,238.9	4,813.6
CNB	-20.2	-20.4	-20.5	-19.1	-9.1
commercial banks	-8,059.2	-5,038.0	-1,410.8	311.0	-491.9
government	-1,517.2	10,304.7	10,296.1	20,815.1	798.4
other sectors	12,450.4	21,115.3	27,686.1	29,131.9	4,516.2
short-term	-8,048.0	42,019.3	19,667.7	24,203.5	-39,685.6
CNB	-24.3	-21.4	843.7	5,060.1	-5,588.8
commercial banks	-3,871.2	37,899.4	-15,344.5	14,802.0	-42,504.0
government	—	—	—	—	—
other sectors	-4,152.5	4,141.3	34,168.5	4,341.4	8,407.2
Total A + B + C	*211,329.9*	*-3,603.3*	*2,294.7*	*81,314.6*	*1,447.0*
D. Net errors and omissions, valuation changes	5,615.1	16,506.7	4,487.5	11,537.0	-782.5
Total A + B + C + D	*216,945.0*	*12,903.4*	*6,782.2*	*92,851.6*	*664.5*
E. Change in reserves (- increase)	-216,945.0	-12,903.4	-6,782.2	-92,851.6	-664.5

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

	2002 31 Dec.	2003 31 Dec.	2004 31 Dec.	2005[1)] 31 Dec.	2006[1)] 31 Mar.
Assets	1,579,922.9	1,537,284.6	1,549,333.7	1,823,960.2	1,782,317.1
Direct investment abroad	44,397.1	58,581.5	84,087.4	104,235.0	105,790.0
- equity capital	39,472.1	50,965.5	70,664.0	81,315.0	82,905.0
- other capital	4,925.0	7,616.0	13,423.4	22,920.0	22,885.0
Portfolio investment	274,344.7	343,968.7	372,237.6	428,697.7	441,007.6
- equity securities	86,464.7	47,337.7	76,121.3	107,846.8	116,829.1
- debt securities	187,880.0	296,631.0	296,116.3	320,850.9	324,178.5
Financial derivatives	31,213.2	24,129.5	39,695.3	41,363.7	43,161.9
Other investment	515,356.2	419,090.0	417,071.9	522,961.8	489,783.8
long-term	179,639.6	157,598.6	118,432.7	136,313.4	135,680.1
- CNB	280.9	468.4	600.0	3,184.5	3,086.7
- commercial banks	67,966.9	66,121.3	58,137.8	83,230.4	87,119.5
- government	97,156.8	79,483.9	48,574.9	38,408.5	35,693.9
- other sectors	14,235.0	11,525.0	11,120.0	11,490.0	9,780.0
short-term	335,716.6	261,491.4	298,639.2	386,648.4	354,103.7
- CNB	376.7	98.8	71.7	71.1	100.8
- commercial banks	213,815.4	161,150.2	184,588.0	273,797.2	225,202.9
of which: gold and foreign exchange	163,032.9	115,884.8	128,119.8	197,959.6	129,669.0
- government	2,324.5	102.4	9.5	0.1	0.0
- other sectors	119,200.0	100,140.0	113,970.0	112,780.0	128,800.0
CNB reserves	714,611.7	691,514.9	636,241.5	726,702.0	702,573.8
- gold	4,653.8	4,784.3	4,253.9	5,526.8	5,950.8
- SDR	137.1	238.7	118.0	289.8	314.4
- reserve position in the IMF	7,081.5	11,949.9	9,137.5	4,447.7	3,099.2
- foreign exchange	686,516.1	674,451.8	622,606.4	716,315.2	693,121.2
- other reserve assets	16,223.2	90.2	125.7	122.5	88.2
Liabilities	1,977,177.7	2,064,768.3	2,374,328.4	2,680,707.6	2,665,782.9
Direct investment in the Czech Republic	1,165,529.1	1,161,783.6	1,280,594.8	1,461,976.8	1,482,317.4
- equity capital	1,013,102.9	1,009,391.8	1,121,842.3	1,303,621.8	1,326,077.4
- other capital	152,426.2	152,391.8	158,752.5	158,355.0	156,240.0
Portfolio investment	201,120.0	223,620.4	381,019.4	437,806.0	447,230.5
- equity securities	128,097.7	140,788.6	208,872.1	220,495.8	223,832.3
- debt securities	73,022.3	82,831.8	172,147.3	217,310.2	223,398.2
Financial derivatives	22,671.9	19,448.3	31,806.1	30,672.7	30,860.3
Other investment	587,856.7	659,916.0	680,908.1	750,252.1	705,374.7
long-term	326,321.3	360,279.2	373,456.4	418,926.2	418,551.4
- CNB	114.5	96.1	70.2	47.8	37.0
- commercial banks	63,541.0	58,056.3	52,020.8	51,639.7	50,459.8
- government	9,475.8	22,456.0	32,065.4	52,372.7	52,998.6
- other sectors	253,190.0	279,670.8	289,300.0	314,866.0	315,056.0
short-term	261,535.4	299,636.8	307,451.7	331,325.9	286,823.3
- CNB	44.2	22.8	866.5	5,926.5	337.9
- commercial banks	176,196.2	208,534.0	185,025.2	201,239.4	155,905.4
- government	—	—	—	—	—
- other sectors	85,295.0	91,080.0	121,560.0	124,160.0	130,580.0
Net investment position	-397,254.8	-527,483.7	-824,994.7	-856,747.4	-883,465.8

1) Preliminary data

Table 14

EXTERNAL DEBT					in CZK millions
	2002 31 Dec.	2003 31 Dec.	2004 31 Dec.	2005[1)] 31 Dec.	2006[1)] 31 Mar.
Debt in convertible currencies	813,305.2	895,139.6	1,011,807.9	1,125,917.3	1,085,012.9
of which:					
Long-term	498,833.8	535,995.9	667,327.6	772,917.0	777,087.1
by debtor					
- CNB	114.5	96.1	70.2	47.8	37.0
- commercial banks	80,063.7	73,276.4	64,346.5	65,418.8	65,594.5
- government	47,701.3	69,029.9	147,729.1	221,054.0	228,248.0
- other sectors	370,954.3	393,593.5	455,181.8	486,396.4	483,207.6
by creditor					
- foreign banks	230,589.8	251,535.3	269,081.3	284,541.7	284,912.9
- government institutions	1,747.2	—	—	9,636.0	9,555.5
- multilateral institutions	69,894.7	83,779.6	84,862.4	98,520.8	98,471.6
- suppliers and direct investors	118,829.4	109,287.9	143,301.2	158,690.0	156,250.0
- other investors	77,772.7	91,393.1	170,082.7	221,528.5	227,897.1
Short-term	314,471.4	359,143.7	344,480.3	353,000.3	307,925.8
by debtor					
- CNB	44.2	22.8	866.5	5,926.5	337.9
- commercial banks	177,474.4	210,017.0	188,495.9	202,540.6	157,822.0
- government	761.0	710.0	3,334.6	1,102.4	896.3
- other sectors	136,191.8	148,393.9	151,783.3	143,430.8	148,869.6
by creditor					
- foreign banks	168,200.7	218,436.1	202,372.6	197,384.4	151,463.7
- multilateral institutions	—	—	861.3	5,918.8	331.5
- suppliers and direct investors	112,256.8	105,563.9	98,611.3	97,025.0	105,110.0
- other investors	34,013.9	35,143.7	42,635.1	52,672.1	51,020.6
Debt in non-convertible currencies	—	—	—	—	—
of which:					
- long-term	—	—	—	—	—
- short-term	—	—	—	—	—
Total external debt	813,305.2	895,139.6	1,011,807.9	1,125,917.3	1,085,012.9
of which:					
- long-term	498,833.8	535,995.9	667,327.6	772,917.0	777,087.1
- short-term	314,471.4	359,143.7	344,480.3	353,000.3	307,925.8
Total long-term debt	498,833.8	535,995.9	667,327.6	772,917.0	777,087.1
of which:					
- IMF loans	—	—	—	—	—
- liabilities of government sector and guaranteed by government, and liabilities of entities with majority owned by state	207,325.2	222,120.9	272,202.1	322,318.0	327,563.9
- liabilities of entities with majority private capital	291,508.6	313,875.0	395,125.5	450,599.0	449,523.2

1) Preliminary data

Table 15

EXCHANGE RATES

in CZK; foreign exchange market rates

A. NOMINAL RATE	2002	2003	2004	2005	2006
	1 - 12	1 - 12	1 - 12	1 - 12	4 - 6
CZK exchange rate against selected currencies					
- annual/quarterly averages					
1 EUR	30.81	31.84	31.90	29.78	28.38
1 USD	32.74	28.23	25.70	23.95	22.59
100 SKK	72.22	76.75	79.69	77.15	75.31
	12	**12**	**12**	**12**	**6**
- monthly averages					
1 EUR	31.19	32.31	30.65	28.98	28.39
1 USD	30.65	26.32	22.87	24.44	22.44
100 SKK	74.67	78.57	78.81	76.51	74.58
	31 Dec.	**31 Dec.**	**31 Dec.**	**30 Dec.**	**30 Jun.**
- last day of the month					
1 EUR	31.60	32.41	30.47	29.01	28.50
1 USD	30.14	25.65	22.37	24.59	22.41
100 SKK	75.18	78.71	78.63	76.57	74.30

B. NOMINAL EFFECTIVE RATE	2002	2003	2004	2005	2006
					6
CZK nominal effective exchange rate (percentages)					
(2000=100)					
weights - foreign trade turnover	116.5	116.0	116.3	123.5	129.7
weights - foreign trade turnover SITC 5-8	116.1	115.6	115.5	122.8	129.1

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

C. REAL EFFECTIVE RATE	2002	2003	2004	2005	2006
					5
CZK real effective exchange rate (percentages)					
(2000=100)					
a) industrial producer prices					
weights - foreign trade turnover	115.2	111.3	114.0	118.9	120.4
weights - foreign trade turnover SITC 5-8	115.9	112.0	115.4	121.1	123.1
b) consumer prices					
weights - foreign trade turnover	116.7	112.9	113.0	118.9	124.9
weights - foreign trade turnover SITC 5-8	117.5	113.7	114.1	120.7	127.1

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

Table 16

PUBLIC FINANCES					in CZK billions
	2002 1 - 12	2003 1 - 12	2004 1 - 12	2005 1 - 12	2006 1 - 6
STATE BUDGET					
Total revenue	705.0	699.7	769.2	866.5	468.8
Tax revenue	627.4	667.5	716.7	770.4	402.4
Taxes on income, profits and capital gains	159.0	172.9	180.7	195.0	98.7
Domestic taxes on goods and services	186.9	198.4	223.2	250.4	135.7
- value-added taxes	118.1	125.6	140.4	146.8	70.4
- excises	68.9	72.9	82.8	103.6	65.4
Taxes on property	7.9	8.8	10.4	8.1	4.0
Social and health security contributions and payroll taxes	258.5	272.4	293.3	311.2	160.5
Non-tax and capital incomes and received subsidies	77.7	32.2	52.5	96.1	66.4
Total expenditure	750.8	808.7	862.9	922.8	461.2
Current expenditure	697.3	745.4	796.8	840.8	436.8
Capital expenditure	53.5	63.3	66.1	82.0	24.3
Public budgets (balance in IMF GFS methodology) [1]	-11.5	-127.7	-90.7	-14.7	__
state budget	-45.7	-104.9	-65.0	-60.5	7.6
local budget	-4.3	-2.9	-8.9	0.5	__
state financial assets	__	__	__	__	__
state funds	12.3	6.9	-13.0	-5.5	__
Land Fund	-0.5	-0.1	0.2	-0.3	__
National Property Fund	28.4	-27.4	-4.2	51.5	__
health insurance companies	-1.2	0.1	0.2	-0.4	__
others	-0.5	0.6	0.0	0.0	__

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

Table 17

CAPITAL MARKET

last day of the month in points

A. STOCK MARKET INDICES	2002 12	2003 12	2004 12	2005 12	2006 6
BCPP					
PX	460.7	659.1	1,032.0	1,473.0	1,390.4
PX-D	1,166.4	1,642.7	2,551.1	3,731.4	__
PX-GLOB	576.8	816.9	1,232.7	1,811.3	1,744.7
RM-SYSTÉM					
PK-30	672.5	947.5	1,443.5	2,365.0	2,281.9

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

in CZK millions

B. TRADE VOLUMES	2002 12	2003 12	2004 12	2005 12	2006 6
BCPP					
Monthly trade volumes	109,264.8	98,640.0	90,610.5	96,160.5	153,513.2
of which:					
a) shares	17,089.3	28,296.0	46,210.3	56,180.3	102,830.5
b) units	0.0	0.0	0.0	0.0	0.0
c) bonds	92,175.5	70,344.0	44,400.2	39,980.2	50,682.7
RM-SYSTÉM					
Monthly trade volumes	4,412.1	1,103.0	335.8	286.7	278.3
of which:					
a) shares	298.4	1,082.5	332.7	220.9	269.1
b) units	1.0	3.7	3.1	0.0	9.2
c) bonds	4,112.7	16.8	0.0	65.8	0.0

Table 18

CNB MONETARY POLICY INSTRUMENTS

	2W repo rate (%)	Discount rate (%)	Lombard rate (%)	Minimum reserve requirement for primary deposits (%)	
				Banks	Building societies and ČMZRB
1999					
18 January	8.75	—	—	—	—
28 January	—	—	—	5.0	—
29 January	8.00	—	—	—	—
12 March	7.50	6.0	10.0	—	—
9 April	7.20	—	—	—	—
4 May	6.90	—	—	—	—
25 June	6.50	—	—	—	—
30 July	6.25	—	—	—	—
3 September	6.00	5.5	8.0	—	—
5 October	5.75	—	—	—	—
7 October	—	—	—	2.0	2.0
27 October	5.50	5.0	7.5	—	—
26 November	5.25	—	—	—	—
2000	No changes made				
2001					
23 February	5.00	4.0	6.0	—	—
27 July	5.25	4.25	6.25	—	—
30 November	4.75	3.75	5.75	—	—
2002					
22 January	4.50	3.50	5.50	—	—
1 February	4.25	3.25	5.25	—	—
26 April	3.75	2.75	4.75	—	—
26 July	3.00	2.00	4.00	—	—
1 November	2.75	1.75	3.75	—	—
2003					
31 January	2.50	1.50	3.50	—	—
26 June	2.25	1.25	3.25	—	—
1 August	2.00	1.00	3.00	—	—
2004					
25 June	2.25	1.25	3.25	—	—
27 August	2.50	1.50	3.50	—	—
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 2000 prices
	2002 Q1 - 4	2003 Q1 - 4	2004 Q1 - 4	2005 Q1 - 4	2006 Q1
Gross domestic product					
- in CZK millions	2,285,488	2,367,818	2,467,615	2,617,783	654,622
- percentages	1.9	3.6	4.2	6.1	7.4
Final consumption					
- in CZK millions	1,709,342	1,817,625	1,832,424	1,865,714	441,995
- percentages	3.5	6.3	0.8	1.8	2.0
of which:					
Households					
- in CZK millions	1,187,163	1,258,158	1,290,086	1,320,539	317,675
- percentages	2.2	6.0	2.5	2.4	3.4
Government					
- in CZK millions	509,591	545,999	528,767	532,242	121,724
- percentages	6.7	7.1	-3.2	0.7	-1.0
Non-profit institutions					
- in CZK millions	12,586	13,362	14,576	14,570	3,562
- percentages	-0.9	6.2	9.1	0.0	0.6
Gross capital formation					
- in CZK millions	720,002	709,600	768,013	789,966	207,755
- percentages	4.6	-1.4	8.2	2.9	16.7
of which:					
Fixed capital					
- in CZK millions	686,128	689,117	721,822	747,836	182,926
- percentages	5.1	0.4	4.7	3.6	7.1
Changes in inventories					
- in CZK millions	30,435	15,642	43,266	39,054	24,050
Acquisitions less disposals of valuables					
- in CZK millions	3,439	4,841	2,925	3,076	779
- percentages	33.0	40.8	-39.6	5.2	2.3
Foreign trade					
of which:					
Exports of goods					
- in CZK millions	1,354,163	1,479,795	1,820,657	2,036,643	562,247
- percentages	5.9	9.3	23.0	11.9	19.9
Exports of services					
- in CZK millions	222,147	212,807	231,549	235,805	51,848
- percentages	-15.7	-4.2	8.8	1.8	-3.3
Imports of goods					
- in CZK millions	1,489,963	1,623,393	1,943,966	2,058,150	544,193
- percentages	4.6	9.0	19.7	5.9	17.1
Imports of services					
- in CZK millions	231,687	235,915	253,370	248,953	58,822
- percentages	7.7	1.8	7.4	-1.7	1.8
Final domestic demand					
- in CZK millions	2,395,470	2,506,742	2,554,246	2,613,550	624,921
- percentages	3.9	4.6	1.9	2.3	3.4
Aggregate domestic demand					
- in CZK millions	2,429,344	2,527,225	2,600,437	2,655,680	649,750
- percentages	3.8	4.0	2.9	2.1	6.3
Gross domestic product at current prices					
- in CZK millions	2,464,432	2,577,110	2,781,060	2,978,157	748,832
- percentages	4.8	4.6	7.9	7.1	8.3

Source: CZSO

Table 20

LABOUR MARKET

annual percentage changes

A. NATIONAL ACCOUNTS FOR THE HOUSEHOLD SECTOR	2002 Q1 - 4	2003 Q1 - 4	2004 Q1 - 4	2005 Q1 - 4	2006 Q1
Current income	6.4	5.9	4.9	5.4	5.8
of which:					
- gross operating surplus and mixed income	2.4	7.7	5.7	3.8	4.5
- compensation of employees	8.5	5.5	5.7	6.1	6.8
- property income	-0.9	5.3	-1.0	5.7	-9.1
- social benefits other than social transfers in kind	8.0	3.6	3.4	5.1	7.1
- other current transfers	4.1	10.9	2.2	5.1	9.7
Current expenditure	8.4	9.5	7.5	5.4	3.5
of which:					
- property income	15.1	21.3	12.4	6.4	19.4
- current taxes on income, wealth, etc.	8.2	12.1	7.7	4.9	-7.3
- social contributions	8.9	7.2	8.3	6.2	5.9
- other current transfers	4.7	12.5	2.8	1.9	4.0
Gross disposable income	5.6	4.3	3.6	5.4	6.9
Change in net equity of households in pension funds reserves	22.6	15.4	29.1	9.8	8.2
Individual consumption expenditure	3.5	6.5	5.6	4.2	6.2
Gross saving	31.8	-15.5	-17.8	26.7	14.3
Gross saving rate	9.90	8.03	5.89	7.08	8.35
(gross saving/gross disposable income - ratio in per cent)					

annual percentage changes

B. AVERAGE WAGES	2002 Q1 - 4	2003 Q1 - 4	2004 Q1 - 4	2005 Q1 - 4	2006 Q1
Whole-economy nominal wage	7.0	6.4	6.2	5.5	6.8
Business sector	6.3	5.5	6.3	5.3	7.0
Non-business sector	9.8	9.8	5.7	6.7	6.0
Whole-economy real wage	5.1	6.3	3.3	3.5	3.9
Business sector	4.4	5.4	3.4	3.3	4.1
Non-business sector	7.9	9.7	2.8	4.7	3.1

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	2002 12	2003 12	2004 12	2005 12	2006 6
Registered job applicants (thousands)	514.4	542.4	541.7	510.4	451.1
Unemployment rate (percentages)	9.8	10.3	10.3	—	—
Unemployment rate (percentages) [1]	—	—	9.5	8.9	7.7

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

Source: CZSO

Table 21

PRODUCER PRICES percentage changes

	2002	2003	2004	2005	2006 6
Industrial producer prices					
a) previous month = 100	-0.1	0.1	0.6	0.0	0.2
b) same period of last year = 100	-0.5	-0.3	5.7	3.0	1.8
c) average for 2000 = 100	2.3	1.9	7.7	10.9	12.6
d) December 1999 = 100	5.8	5.4	11.4	14.7	16.4
Construction work prices					
a) previous month = 100	0.2	0.2	0.4	0.2	0.7
b) same period of last year = 100	2.7	2.2	3.7	3.0	2.8
c) average for 2000 = 100	6.9	9.2	13.3	16.6	19.6
d) December 1999 = 100	9.3	11.7	15.8	19.3	22.4
Agricultural producer prices					
b) same period of last year = 100	-9.5	-2.9	8.1	-9.2	8.8
of which:					
crop products					
b) same period of last year = 100	-4.6	-1.0	11.6	-25.0	32.0
livestock products					
b) same period of last year = 100	-12.1	-4.0	6.1	0.4	-2.6
Market services prices					
a) previous month = 100	0.3	0.0	0.2	0.1	-0.4
b) same period of last year = 100	3.2	1.6	2.3	1.9	3.4
c) average for 2000 = 100	7.3	9.0	11.5	13.7	18.5
d) December 1999 = 100	8.0	9.7	12.2	14.4	19.2

Source: CZSO

Table 22

RATIOS OF KEY INDICATORS TO GDP					percentage ratios
	2001	2002	2003	2004	2005
Public budgets balance	-2.1	-0.5	-5.0	-3.3	-0.5
Public debt	17.2	18.0	21.5	23.7	25.6
Debt in convertible currencies	34.5	33.0	34.7	36.4	37.8
Trade balance [1)]	-5.0	-2.9	-2.7	-1.0	1.4
Current account balance	-5.3	-5.5	-6.2	-6.0	-2.1
M2	67.9	67.0	68.5	66.3	66.9

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

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CZECH NATIONAL BANK
Na Příkopě 28
115 03 Prague 1
CZECH REPUBLIC

Contact:
COMMUNICATIONS DEPARTMENT
Tel.:+420 22441 3494
Fax: +420 22441 2179

http://www.cnb.cz

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