INFLATION REPORT / JANUARY

2007

CNB CZECH NATIONAL BANK

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ABBREVIATIONS USED

ARA	Amsterdam-Rotterdam-Antwerp
BCPP	Prague Stock Exchange
ČEZ	České energetické závody, a power utility company
ČMZRB	Czech-Moravian Guarantee and Development Bank
CNB	Czech National Bank
CPI	consumer price index
ČSOB	Československá obchodní banka
CZK	Czech koruna
CZ-NACE	Industrial Classification of Economic Activities
CZSO	Czech Statistical Office
ECB	European Central Bank
EIB	European Investment Bank
ERM	Exchange Rate Mechanism
ESA	European System of National Accounts
EU	European Union
EU-10	The countries that joined the EU in 2004
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
HUF	Hungarian forint
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
MFIs	monetary financial institutions
MI	Ministry of the Interior
MLSA	Ministry of Labour and Social Affairs
MNB	Hungarian National Bank
NBP	National Bank of Poland
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
PLN	Polish zloty
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

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 1 February 2007.

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 below the lower boundary of the tolerance band of the inflation target in 2006 Q4
(annual percentage changes in CPI)

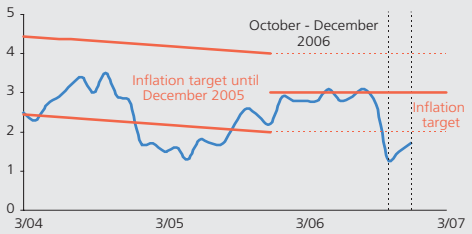


Table I.1
The Czech economy continued to grow at a fast pace in 2006 Q3
(annual percentage changes unless otherwise indicated)

	9/06	10/06	11/06	12/06
Consumer price inflation	2.7	1.3	1.5	1.7
Industrial producer price inflation	2.4	1.9	2.0	2.6
Money supply growth (M2)	9.2	9.9	9.0	-
3M PRIBOR[a)] (in per cent)	2.5	2.7	2.6	2.6
CZK/EUR exchange rate[a)] (level)	28.38	28.29	28.03	27.78
State budget balance since January [b)] (CZK bn)	1.5	-12.7	-30.9	-97.3
GDP growth at constant prices [c)]	5.8			-
Unemployment rate [d)] (in per cent)	7.8	7.4	7.3	7.7

a) average level for the month
b) incl. SFAOs, end-of-month position
c) figure for the quarter ending with the given month
d) registered unemployment (MLSA); end of month position

Inflation fell below the lower boundary of the tolerance band of the CNB's inflation target in 2006 Q4 (see Chart I.1). The Czech economy grew at a fast pace in 2006 Q3 (see Table I.1), despite a further gradual decrease in the rate of growth, manifesting itself in a slight slowdown in employment growth. Short-term money market interest rates were stable during 2006 Q4, but interest rates at longer maturities started declining slightly in November. The koruna's exchange rate appreciated against both major world currencies in this period.

Annual consumer price inflation fell significantly in 2006 Q4. In October, inflation declined to roughly half its September figure, and in the remaining months of the year it increased only very slightly. This decline in inflation was due mainly to a sharp slowdown in growth in regulated prices, especially in the category of housing, water, energy and fuels. Food prices contributed to this process to a lesser extent. Although the contribution of regulated prices to headline inflation fell by roughly one-half compared to the previous quarter, they continued to account for most of the annual consumer price inflation.

According to preliminary CZSO estimates, the slight slowdown in annual GDP growth recorded in 2006 H1 continued into Q3. Nevertheless, the Czech economy continued growing at a rapid, almost 6% rate. The Q3 results confirm the gradual change in tendency in the expenditure components of GDP signalled in the previous quarter, which is affecting their contributions to economic growth. The contribution of foreign trade has been significantly lower since the beginning of 2006, following two years of dominance. On the other hand, the contributions of inventories and fixed investment have increased, and the contribution of household final consumption expenditure remains relatively high.

The labour market was significantly affected in 2006 Q3 by the continuing rapid, albeit gradually slackening, growth in the Czech economy. In these conditions, employment continued growing, but at a slower pace than in previous quarters. The annual decline in registered unemployment was still slower than the growth in employment, but much less so than in the past. Annual nominal and real wage growth slowed slightly again in Q3, but remained relatively high. Wages in the business sector continued rising faster than those in the non-business sector, but their lead again narrowed slightly.

Short-term interest rates on the money market were flat in 2006 Q4. Interest rates at longer maturities started falling steadily in November, and in December they were close to the values recorded in early September. Interest rates were affected in particular by a shift in market expectations towards a later and more moderate monetary policy tightening.

The koruna's exchange rate appreciated against both the euro and the dollar in 2006 Q4, reaching historical highs against both currencies in mid-December. This appreciation was chiefly due to the growing attractiveness of the Central European region to investors, linked with expected rapid economic growth and future appreciation of the Central European currencies. The koruna's exchange rate was also supported by sales of dollars for Czech korunas by some foreign investors, who started turning away from investing in dollars.

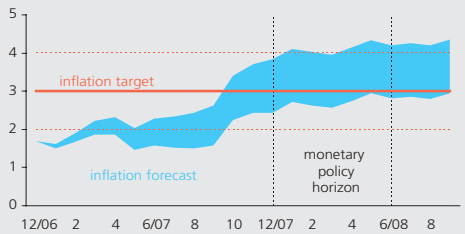
The monetary policy decision-making of the CNB Bank Board in 2006 Q4 was based on the inflation forecast discussed by the Board at its meeting on 26 October 2006 and published in the October Inflation Report. Given the monetary policy transmission lag, the Board focused on hitting the inflation target at roughly the 12–18 month horizon, i.e. in 2007 Q4 and 2008 Q1. According to the forecast, headline inflation should be close to the upper boundary of the tolerance band of the inflation target in this period. Inflation adjusted for the first-round effects of changes to indirect taxes at the monetary policy horizon should first be below the

point inflation target, but subsequently grow slightly above it. Consistent with the baseline scenario was a gradual rise in interest rates.

After increasing its monetary policy interest rates in late September, the Bank Board left rates unchanged in 2006 Q4. As the quarter progressed, the view of the risks of the forecast became increasingly anti-inflationary. The main downside risks to inflation, according to the Board, were the appreciation of the koruna, the combination of the weaker dollar and lower oil prices, and the lower-than-forecasted inflation in Q4. The main upside risk, according to the Board, was potential higher growth of the Czech economy, and, within it, of consumer demand in particular, and the slightly higher-than-expected growth in the euro area.

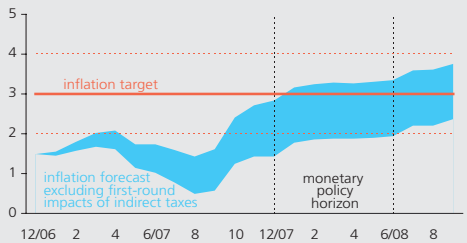
Section IV of this Inflation Report describes the CNB's new forecast. Starting with this forecast, the CNB's modelling system has been extended to include the effect of real wage costs (see Box 2 *The extension of the core prediction model to include the effect of real wages*). New data on domestic economic activity have led to a slight reduction in the estimate of the current inflation pressures from the real economy, but the effect of the real economy remains slightly inflationary. Inflation pressures from the real economy are approximated in the extended model by the so called real marginal cost gap. Over the forecast horizon, this gap will initially increase and then gradually decrease from slightly positive to slightly negative values. Its first component – the output gap – will have a modest inflationary effect over the forecast horizon, as at present, but this effect will gradually weaken. The second component of the real marginal cost gap – the real wage gap – had an anti-inflationary effect in 2006. At the beginning of the forecast period it will close, but in 2008 it will return to negative values.

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



The inflation forecast has been revised downwards as a consequence of the lower inflation recorded in 2006 Q4, the lower growth in indirect taxes in 2007, the appreciation of the koruna at the end of last year and the decrease in inflation pressures from the real economy. However, the forecast of a gradual rise in prices remains unchanged, chiefly as a result of rising regulated prices and a high contribution from changes to indirect taxes. The forecast also predicts rising adjusted inflation excluding fuels and accelerating food price inflation. At the monetary policy horizon, i.e. in 2008 H1, inflation will be in the upper half of the tolerance band of the inflation target.

Chart I.3
Excluding the first-round impacts of indirect taxes, the inflation forecast is in the lower half of the tolerance band of the inflation target at the monetary policy horizon
(annual percentage changes)



The mechanism of caveats applies as usual to the first-round effects of indirect taxes, whose impact at the monetary policy horizon is pronounced. Adjusted for these effects, inflation to which monetary policy reacts is in the lower half of the tolerance band of the inflation target at the monetary policy horizon and is gradually rising towards the target. Consistent with the macroeconomic forecast and its assumptions is broad interest rate stability initially and then a gradual rise in nominal interest rates at the forecast horizon.

No full alternative scenario was drawn up in the forecasting process. Sensitivity analyses were conducted covering the uncertainty regarding future exchange rate developments in the baseline scenario of the forecast.

Chart II.1
Inflation decreased significantly in 2006 Q4
(percentages)

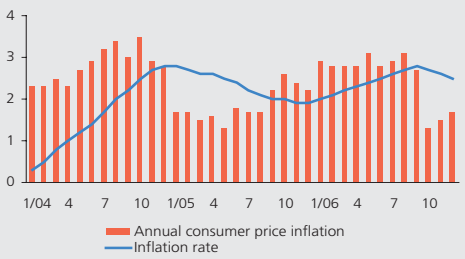


Table II.1
Most categories of the consumer basket recorded relatively low inflation or falling prices
(annual percentage changes)

	9/06	10/06	11/06	12/06
CONSUMER PRICES	2.7	1.3	1.5	1.7
Food and non-alcoholic beverages	2.6	1.2	1.1	1.9
Alcoholic beverages and tobacco	1.4	1.4	1.7	0.9
Clothing and footwear	-5.9	-5.8	-5.4	-4.6
Housing, water, electricity, gas and other fuels	6.9	3.9	3.9	3.9
Furnishings, household equipment and routine maintenance of the house	-1.1	-1.1	-0.9	-0.7
Health	5.6	5.9	5.6	5.6
Transport	-2.0	-3.3	-2.5	-0.7
Communication	2.8	2.9	2.9	2.9
Recreation and culture	2.1	0.3	0.1	0.4
Education	3.1	2.5	2.5	2.5
Hotels and restaurants	2.5	2.3	2.4	2.6
Miscellaneous goods and services	2.2	2.2	2.1	2.1

Chart II.2
Housing prices remained the main factor underlying annual consumer price inflation in 2006 Q4
(contributions in percentage points; December 2006)

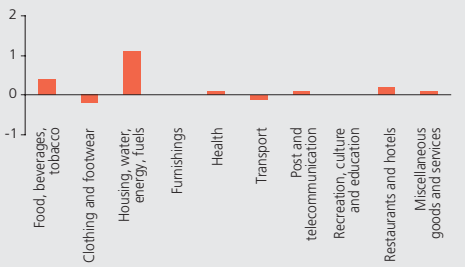
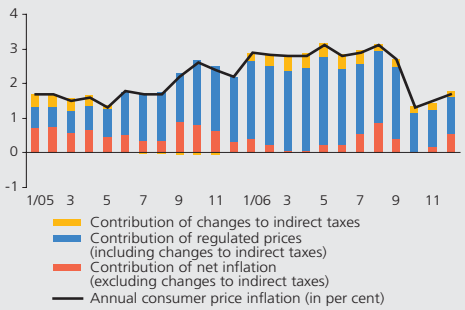


Chart II.3
Consumer price inflation was again affected most strongly by regulated prices in 2006 Q4; the effect of market prices was small
(percentages; contributions in percentage points)



II.1 PAST INFLATION DEVELOPMENTS

Annual inflation fell significantly[1] in 2006 Q4, thus continuing the decline recorded at the end of Q3 (see Chart II.1). In December 2006 it stood at 1.7%, 1 percentage point lower than in September. This fall was reflected in a change in trend in the inflation rate[2], whose slow rise since the beginning of 2006 was replaced by a slight decline at the close of the year. The inflation rate stood at 2.5% in December.

The slowdown in annual consumer price inflation in 2006 Q4 was due mainly to slowing growth in regulated prices. In the consumer basket this change manifested itself in a considerable decline in inflation in the housing category (see Table II.1). Nevertheless, continuing relatively rapid inflation in the housing category remained the main factor underlying annual consumer price inflation (see Chart II.2). Growth in food prices also slowed, although they contributed to the fall in consumer price inflation to a much lesser extent than regulated prices. Inflation also decreased in four other categories of the consumer basket, but their effect on the overall change in consumer price inflation was insignificant. Overall, the low inflation was attributable to a majority of the consumer basket categories.

A significant factor for domestic prices in 2006 Q4 was weakening external cost pressures stemming from the growth in prices of energy-producing materials on world markets. Annual growth in oil prices slowed and, coupled with a sharp year-on-year appreciation of the koruna, fostered a decline in import prices of mineral fuels, which subsequently passed through in particular to producer prices in the manufacture of refined petroleum products. Electricity prices continued rising quickly, and producer price inflation in the manufacture of basic metals has picked up pace since mid-2006. Overall, however, moderate inflation prevailed in other branches of industry in Q4, with some branches recording a halt in their upward inflation trend. This was also aided by a declining personnel cost-output ratio. Construction and market services price inflation stayed broadly at the levels recorded in the previous quarters of 2006. Agricultural producer price inflation rose significantly in December.

By the CNB's estimation, the economy has been exceeding the potential, non-accelerating inflation level of output since 2005 Q4. However, the current trend suggests that the real economy is still not generating strong inflation pressures. Although consumer demand growth remains at a stable and relatively high level, consumer prices are so far not indicating any noticeable inflation pressures. This is evidenced in particular by low goods price inflation (below 1%) and by broadly subdued services price inflation. Pronounced inflation is being recorded only in the housing category, which is being affected by previous growth in prices of energy-producing commodities, and in the health category, where a long-term upward trend in prices can be identified. Overall, developments on the labour market are having rather an anti-inflationary effect, since growth in the personnel cost-output ratio is generally modest.

Under these circumstances, regulated prices, whose annual growth fluctuated around 5% (see Chart II.3), were again the main source of annual consumer price inflation in 2006 Q4. Market price inflation was generally very moderate in Q4. In October and November it was at near-zero values, and in December it edged up to 0.7%. The modest growth in market prices was due to both food and non-food

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.

commodities. In December, non-food commodity prices increased by 0.5% and food prices rose by 0.9% (excluding tax changes; including tax changes the figure was 1.6%). Annual food price inflation eased in 2006 Q4, being almost 1 percentage point lower than in the previous quarter.

The gradual rise in food price inflation[3] visible since 2006 Q2 was replaced in Q4 by slower growth in prices (see Chart II.4). The factors underlying this change were virtually the same as those responsible for the previous pick-up in inflation. They included in particular substantially slower growth in prices of some fruit and vegetable items with volatile prices. The sharp annual growth in prices of bread products – generated in Q3 primarily by rising prices of energy and other inputs and subsequently bolstered by a stronger bargaining position of producers in this industry in relation to large retailers – also partially moderated. In other food categories, a decline in prices still prevailed. Prices of tobacco products increased by 1.5% year on year at the end of 2006. The increase in taxes on tobacco products and cigarettes as from April 2006 had yet to pass through to prices, owing to high stocks of cigarettes produced prior to this date.

The generally modest annual growth in prices of non-food commodities[4], which fluctuated well below 1% again in 2006 Q4[5], continued to show very mixed structural trends. As mentioned in previous Inflation Reports, this was due to the considerable diversity of the key factors affecting prices in the individual components of this price index. Fuel prices, the most volatile component of this price index, displayed a very significant year-on-year decline as from September (of up to 10.8% in October), until December, when the decline moderated to 3.4%. This fall was a response to a further annual growth slowdown in oil prices on world markets, which, coupled with a sharper annual appreciation of the koruna-dollar exchange rate, led to a fall in import prices of mineral fuels and subsequently to price cuts by domestic fuel producers.

Unlike fuels, prices of other non-food commodity categories remained relatively stable, as evidenced by the only gradual changes in their development illustrated in Chart II.5. Prices of tradable commodities again displayed an annual decline in 2006 Q4, reaching 2.1% in December. The falling prices in this category are a long-term phenomenon that has been ongoing since the beginning of 2001 and is a result of several factors. Prices of these commodities are influenced in particular by the external competitive environment, which affects domestic prices via import prices of consumer goods. The current decline in prices of other tradable commodities is due to the strong year-on-year appreciation of the koruna-euro and koruna-dollar exchange rates combined with relatively low prices of many consumer products on foreign markets. Consumer prices have been recording a long-running decline particularly in the categories of clothing and footwear and household equipment and furnishings, as shown in Chart II.6.

By contrast, prices of non-tradable commodities, which consist primarily of services, continued to display annual growth in 2006 Q4 (2.5% in December). This was in line with the previous four quarters, when prices showed growth in the range of 2.2% and 2.6% and for the most part were affected only by the domestic competitive environment.

CHART II.4
Annual food price inflation slowed in 2006 Q4
(annual percentage changes)

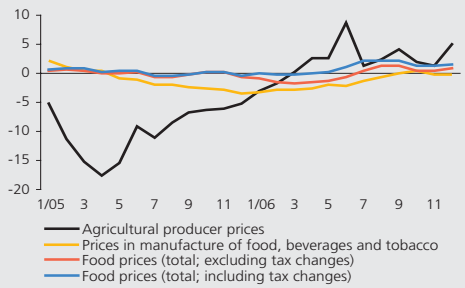


CHART II.5
Prices of non-food commodities were fairly stable; only fuel prices recorded greater fluctuations
(annual percentage changes)

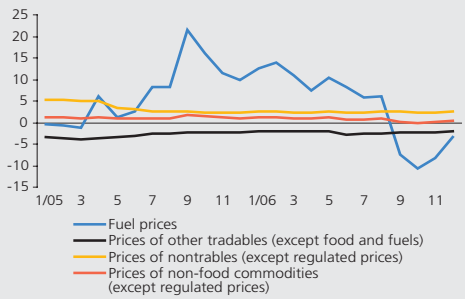
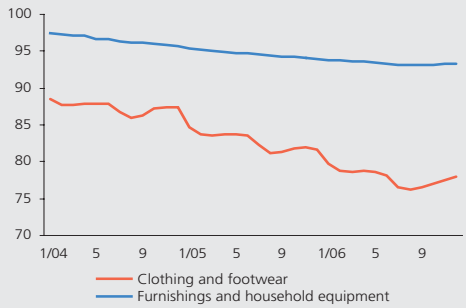


CHART II.6
In the category of tradable commodities, prices of durable goods have long been falling
(2000 average = 100)



3 Consolidated category of prices of food and non-alcoholic beverages and prices of alcoholic beverages and tobacco.

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

5 In October the figure was -0.1%.

Chart II.7
Falling gas prices accounted for most of the slowdown in regulated price inflation
(annual percentage changes)

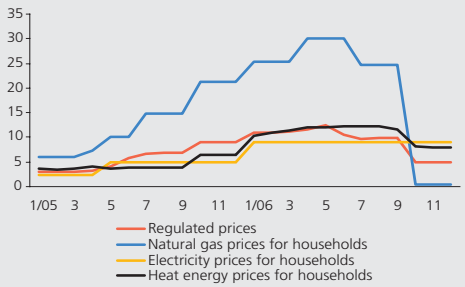


Chart II.8
Inflation in the Czech Republic was lower than in the EU countries in 2006 Q4
(annual percentage changes)

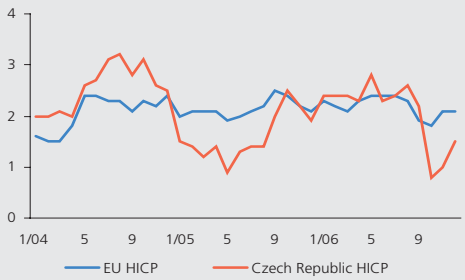
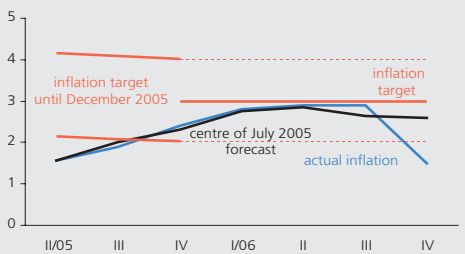


Table II.2
Inflation was lower than forecasted in all price categories except regulated prices in 2006 Q4
(annual percentage changes; contributions in percentage points)

	July 2005 forecast	2006 Q4 outturn	Contribution to total difference a)
Consumer prices	2.6	1.5	-1.1
Breakdown into contributions:			
regulated prices	3.1	4.9	0.4
changes to indirect taxes	0.4	0.2	-0.2
food prices b)	1.4	0.6	-0.2
fuel prices b)	1.1	-7.5	-0.3
adjusted inflation excl. fuels b)	2.2	0.7	-0.7

a) owing to rounding, the sum of the contributions need not be equal to the total difference
b) excluding changes to indirect taxes

Chart II.9
Actual inflation deviated from the July 2005 forecast in 2006 Q4
(annual percentage changes)



Annual growth in regulated prices slowed sharply in 2006 Q4 (from 9.8% in September to 4.9% in December). The main reasons were a decrease of 5.5% in prices of natural gas for households in October 2006, and base effects. As illustrated in Chart II.7, regulated price inflation was driven primarily by rapidly rising prices of electricity and heat for households. Natural gas prices stopped contributing to annual regulated price inflation in Q4. The effect of changes in prices of other regulated items on overall annual regulated price inflation was less significant.[6]

Turning to international comparisons, annual HICP inflation in the Czech Republic decreased below that in the EU countries in the final quarter of 2006. The factors underlying this change compared to the previous period of 2006 were the same as those which led to the fall in the CZSO's consumer price index in Q4. According to Eurostat's latest figures, annual HICP inflation in the Czech Republic was 1.5% in December. HICP inflation in the EU countries was 0.6 percentage point higher.

II.2 FULFILMENT OF THE INFLATION TARGET

Headline inflation was below the lower boundary of the tolerance band of the CNB's inflation target in 2006 Q4 (see Chart I.1). This section of the Inflation Report briefly analyses the contribution of the CNB's monetary policy to this situation.

Changes to interest rates pass through to inflation most strongly with a lag of roughly 12 to 18 months. Accordingly, to assess the effect of monetary policy on the fulfilment of the inflation target in 2006 Q4, one needs to analyse retrospectively the forecasts, and the Bank Board's decisions based thereon, dating from around April to December 2005. For comprehensibility, the analysis of the accuracy of the forecasts is limited here to a comparison of the forecast drawn up in July 2005, i.e. approximately in the middle of the aforementioned period, with inflation in 2006 Q4 (see Table II.2).

The starting monetary conditions had been assessed as slightly easy in the forecast drawn up in July 2005; they had also been expected to have a slightly easy to easy effect over the entire forecast horizon. However, due to flat external demand and an expected slight fiscal policy tightening, the negative output gap was not expected to start gradually closing until the second half of 2006, with full closure occurring in 2007. According to the July forecast, headline annual inflation was to start rising from values below the target band, primarily as a result of developments in regulated prices, fuel prices and food prices and subsequently rising inflation expectations. At the monetary policy horizon, inflation was expected to be slightly below the CNB's point inflation target.

Except in 2006 Q4, actual inflation was close to the July forecast (see Chart II.9), although this was due to mutually offsetting effects that had not been predicted by the forecast. These effects included, in particular, an unexpectedly strong appreciation of the exchange rate and, conversely, higher-than-expected growth in regulated prices and slightly higher inflation pressures from the real economy. In 2006 Q4, inflation fell below the lower boundary of the tolerance band of the inflation target. Downside deviations from the forecast were recorded for adjusted inflation excluding fuels, as well as for fuel and food prices and the first-round

6 Only rail fares rose noticeably in December (by 3.5%).

effects of the changes to indirect taxes. This downside effect was only partly offset by higher-than-expected regulated prices.

The unexpected evolution of factors lying partly or completely outside the purview of the CNB's monetary policy had an upside effect on inflation overall and a different impact on the inflation structure than that expected by the July 2005 forecast. These factors included higher-than-expected growth in regulated prices, linked partly with the evolution of energy-producing material prices on world markets, and higher-than-expected external economic activity, inflation and interest rates. The smaller impact of the increases in excise duties on cigarettes in June 2005 and April 2006 had a downside effect.

The real monetary conditions were easier overall than predicted by the forecast until the end of 2005, but were subsequently tighter. Consistent with the July forecast was interest rate stability over the next several quarters and a slight rise in rates thereafter. The actual monetary policy interest rate path was roughly consistent with the July forecast, as the rates were initially flat for a short time then started to rise gradually by a total of 0.75 percentage point. In the key period as regards recent consumer price developments, i.e. in 2005 Q2–Q4, domestic nominal interest rates were slightly higher overall compared to the July forecast. However, both domestic and foreign real interest rates were lower than expected in this period. The setting of the interest rate component of the real monetary conditions in this period was roughly consistent with the forecast. This assessment simultaneously reflects a change in the view of the equilibrium interest rate level and in the description of inflation expectations, as well as the higher-than-expected inflation adjusted for the first-round effects of the changes to indirect taxes. The nominal koruna-euro exchange rate was stronger than forecasted, but its effect in 2005 H2 is assessed as easier than in the July forecast owing to changes in the estimated rate of equilibrium real appreciation. Owing to the exchange rate appreciation at the start of 2006, a tightening of the exchange rate component followed, and the exchange rate was significantly more anti-inflationary than predicted in the July forecast. The exchange rate was the most significant anti-inflationary factor underlying the non-fulfilment of the July 2005 inflation forecast.

When assessing the fulfilment of the inflation forecast, one needs to take into account the changes in the CNB's view of the workings of the economy. The most fundamental changes since July 2005 include a changeover to effective indicators of external economic development, the aforementioned changes to the equilibrium paths of the real exchange rate and real interest rates, and an extension of the core prediction model to include the inflationary effect of real wages (see Box 2 *The extension of the core prediction model to include the effect of real wages*). In connection with the extension of the core prediction model, the way in which the formation of inflation expectations is described was also changed. As a result of these changes, other things being equal, the exchange rate component is regarded as easier, and the interest rate component as tighter, than the assessment in the July forecast. However, the assessment of the evolution of the monetary conditions as a whole is largely unchanged by these revisions.

Any revisions to economic indicators, in particular GDP, made since the forecast was drawn up, also have an effect on the fulfilment of the forecast. These revisions, especially those made to the national accounts in March 2006, have markedly changed the estimate of GDP growth in 2004 and 2005. In the absence of any observed inflation pressures from the real economy, and given the anti-inflationary effect of real wages between 2005 and 2006, the revision of the national accounts has generated an increase of up to one percentage point in the estimated growth of the potential, non-accelerating inflation level of output.

Table II.3
The external economic recovery, rates and the price of oil were all higher than forecasted

		III/05	IV/05	I/06	II/06	III/06	IV/06
GDP in Germany [a)]	p	1.0	1.3	1.4	1.4	1.4	1.4
	o	1.4	1.1	2.3	2.1	2.3	-
GDP in euro area [a),d)]	o	1.5	1.3	2.4	2.4	2.4	-
CPI in Germany [b)]	p	1.4	1.1	1.2	1.0	1.4	1.7
	o	2.1	2.2	2.0	2.0	1.6	1.2
CPI in euro area [b), d)]	o	2.1	2.2	2.0	2.0	1.7	-
1Y EURIBOR	p	2.1	2.0	2.0	2.1	2.1	2.2
(percentages)	o	2.2	2.6	3.0	3.3	3.6	3.9
USD/EUR exchange rate	p	1.23	1.25	1.26	1.27	1.28	1.29
(levels)	o	1.22	1.19	1.20	1.26	1.27	1.29
Oil prices - Ural [c)]	p	45.3	42.8	41.8	41.3	41.3	41.3
	o	57.3	53.3	57.6	65.0	65.7	56.4
Oil prices - Brent [c), d)]	o	61.6	56.9	62.0	69.8	70.2	59.6

p - prediction, o - outturn
a) at constant prices; annual percentage changes; seasonally adjusted
b) annual percentage changes,
c) USD/barrel
d) no comparison with the prediction is given, as the indicator was not tracked in the July 2005 forecast

Table II.4
The koruna-euro exchange rate was stronger than expected

		III/05	IV/05	I/06	II/06	III/06	IV/06
3M PRIBOR	p	1,9	1,9	1,9	2,1	2,3	2,5
(percentages)	o	1,8	2,1	2,1	2,1	2,4	2,6
CZK/EUR exchange rate	p	30,0	30,2	30,3	30,3	30,2	30,1
(levels)	o	29,7	29,3	28,6	28,4	28,3	28,0
Real GDP	p	4,0	3,8	3,7	3,9	4,3	4,6
(annual perc. changes)	o	6,0	6,7	6,4	6,0	5,8	-
Inflation pressures	p [a)]	-0,6	-0,7	-0,7	-0,6	-0,4	-0,2
from the real economy	o [b)]	-0,6	-0,4	-0,3	-0,2	0,0	0,2

p - prediction, o - outturn
a) output gap as a percentage of GDP
b) real marginal cost gap; estimate based on the CNB's January 2007 forecast

Based on the CNB's current knowledge of the workings of the Czech economy and its current knowledge of actual economic developments, the developments since the July 2005 forecast was drawn up can be summed up in the following way.

The real marginal cost gap, which in the core prediction model approximates the overall inflation pressures from the real economy, remained negative throughout 2005 and had an anti-inflationary effect. However, this effect gradually weakened until the gap closed in 2006 H2. Underlying this was an inflationary output gap and an anti-inflationary real wage gap. The output gap has been positive since 2005 Q4 and has remained so in recent quarters thanks to the recovery abroad and a positive contribution of fiscal policy despite the broadly neutral monetary conditions. The real wage gap has been negative since 2005, mainly because of a rise in inflation due to a cost shock. According to the current view, the inflation pressures from the real economy were thus slightly higher than predicted by the forecast in July 2005 over the entire forecast horizon. However, they did not translate into higher adjusted inflation excluding fuels, since the greater-than-expected strengthening of the koruna had a strong anti-inflationary effect. The exchange rate effect also lay behind the lower-than-expected fuel and food price inflation. Food prices were also affected by the good harvest in 2005 and fuel prices by world oil prices. The first-round effects of the changes to indirect taxes on cigarettes materialised to a smaller extent, and with a lag, compared to the assumptions of the forecast. Regulated prices rose more than expected, mainly as a result of increases in energy prices for households and telecommunication fees. Overall, therefore, the deviations of the individual components of inflation from the forecast shifted inflation below the lower boundary of the tolerance band of the CNB's inflation target in 2006 Q4.

The inflation forecast is the primary source material for the Bank Board's decisions on monetary policy rates. Also of importance is an assessment of the risks associated with this forecast by the board members. At the Board's meetings in 2005 Q2–Q4 (see the relevant minutes), the risks of the forecasts drawn up in the key period were assessed by the Board as being roughly balanced. The risks of the October 2005 forecast were assessed in November and December 2005 as being on the downside. However, the monetary policy decisions of the CNB Bank Board remained in line with the forecast. Although the most significant upside and downside risks to inflation did materialise, the unexpected downside effects prevailed over the upside ones at the time of the cost shock. One can say with the benefit of hindsight that monetary policy could have been easier in the key period and could thus have reduced the undershooting of the inflation target in 2006 Q4.

III.1 THE EXTERNAL ENVIRONMENT

The rate of growth of the US economy slowed further in 2006 Q3 and its lead over the euro area, where economic growth weakened only slightly, decreased further. By contrast, economic growth in the countries of the Central European region picked up pace and was significantly higher than in the euro area. The dollar's exchange rate depreciated very rapidly at the end of November, weakening by roughly 4% to 1.31–1.33 USD/EUR, where it fluctuated until the end of 2006. The depreciation of the dollar on world markets was connected with the less favourable development of the US economy (in particular lower economic growth than expected by the financial markets, which affected the outlook for interest rates, and a higher current account deficit) and possibly also with the slightly higher-than-expected economic growth in the euro area. Prices of oil decreased substantially in Q4, the average price of Brent crude oil being 15% lower than in Q3.

The rate of growth of the US economy dropped by 0.5 percentage point to 3% in 2006 Q3 compared to Q2. Growth in investment and consumption fell in particular, affected negatively and strongly by a fall in the housing market. Property prices declined quarter on quarter and year on year, as did the number of building permits and housing starts. Growth in investment in non-residential properties, machinery and software remained robust. The unemployment rate stayed at 4.5% in December. In Q4 it declined on average by more than 0.2 percentage point compared to Q3 and by 0.5 percentage point relative to the same period a year earlier. The US economy created more than 400,000 new jobs in Q4. The tight situation on the labour market was also reflected in rapid growth in nominal wages and, due to low inflation, in real wages as well. The external imbalance of the US economy deteriorated. The current account deficit widened by USD 42 billion year on year in Q3, reaching 6.8% of GDP, compared to a deficit of 5.8% of GDP a year earlier. The trade balance worsened by USD 19 billion year on year.

Consumer and producer price inflation in the USA started to decline significantly in September thanks to the lower energy prices. Consumer prices increased by 2.6% year on year in December, while producer prices rose by 1.2%. By contrast, core inflation remained relatively high. At its meetings in October and December, the Fed left its key monetary policy rate unchanged at 5.25% and did not rule out further increases in 2007. Despite the decline in consumer and producer price inflation generated by the decrease in energy prices, the Fed regards the inflation pressures as significant, owing to the high core inflation and the tight situation on the labour market.

The annual rate of economic growth in the euro area rose significantly in 2006 Q2 and Q3 to just under 3%. Although GDP growth fell back slightly to 2.7% in Q3 compared to Q2, it still exceeded the growth rate of potential output by the ECB's estimation. It was positively affected by a sizeable increase in economic growth in the largest European economy, Germany. Sluggish GDP growth in France and Italy (below 2%) meanwhile curbed the rate of growth of the euro area as a whole. The expansion was attributable in particular to large increases in fixed investment of around 5% and growth in government and private consumption of around 2%. In Q3, the contribution of net exports declined and export growth slowed, while import growth remained at the previous quarter's level. The rapid economic growth fostered a further year-on-year fall (of more than 1 percentage point) in the unemployment rate, which dropped to 7.6% in November. The external balance of the euro area improved in September and October compared to the same period a year earlier. The current account deficit decreased and the trade surplus increased. However, the opposite is true for developments since the beginning of 2006, as the cumulative sum of the trade balances for the first eleven months of 2006 deteriorated by roughly EUR 29 billion compared to 2005.

Chart III.1
The dollar-euro exchange rate depreciated at the end of November to its lowest level in 2006

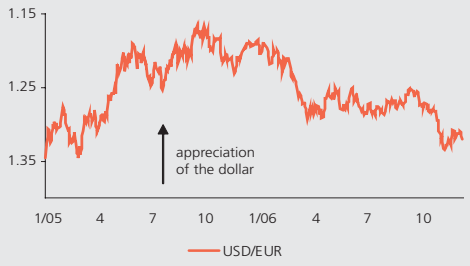


Chart III.2
The average price of Brent crude oil fell by almost 15% in 2006 Q4 relative to Q3
(USD/barrel)

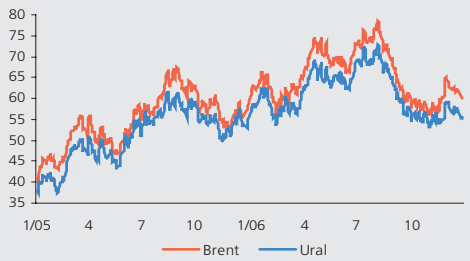
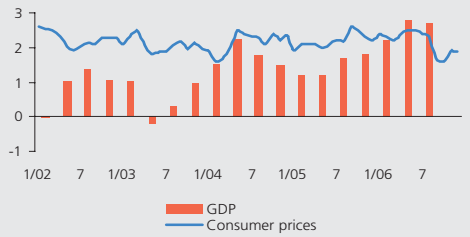


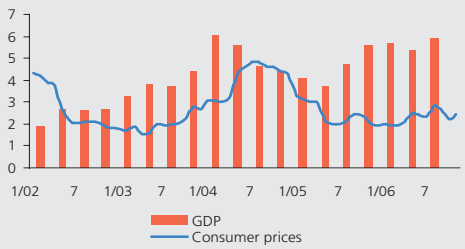
Chart III.3
The euro area recorded continuing relatively strong economic growth in 2006 Q3
(annual percentage changes)



Annual consumer price inflation in the euro area rose to 1.9% in November and December. However, inflation was down significantly compared to 2006 H1 thanks to the fall in energy prices. The ECB raised its key rate twice, in October and December, each time by 0.25 percentage point, to 3.5%. These rises were due to the robust economic growth in the euro area, which is predicted to continue in 2007, and to falling unemployment accompanied, so far, by modest growth in nominal wages and high M3 growth. M3 rose by 9.3% year on year in November, by contrast to the figure of 4.5% which the ECB considers appropriate.

The annual growth of the German economy, which is being driven primarily by investment and exports, rose further to 2.8% in 2006 Q3. The high growth in investment and exports, facilitated by the growing competitiveness of the German economy caused primarily by a decline in real wages over the last three years, manifested itself in solid growth in industrial production, which rose by 5.5% year on year in September–November. The robust economic growth was also reflected in an annual decline in unemployment of 1.4 percentage point and a rise in employment of 0.9%. The high competitiveness also led to year-on-year increases in the current account and trade surpluses in October and November. Thanks to the fall in energy prices, German consumer price inflation has fallen markedly since September. Like core inflation, it fluctuated 0.5 percentage point below the euro area level in Q4, despite the fast economic growth. The robust economic growth coupled with a decline in government expenditure caused the public finance deficit for 2006 as a whole to fall below the 3% level, to 2.1% of GDP.

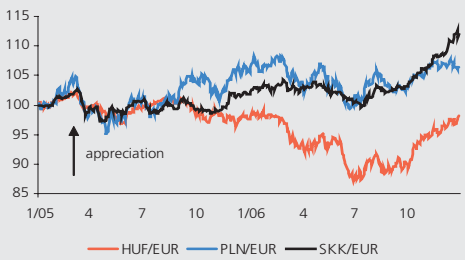
Chart III.4
In the EU-10, GDP growth accelerated to almost 6% on average in 2006 Q3
(annual percentage changes)



In the countries of the Central European region, the pace of economic expansion remained high in Q3, considerably exceeding that in the euro area and increasing further. Slovakia remained the fastest growing economy in the region. In the EU, faster growth was recorded only by Latvia and Estonia. Inflation rose slightly. Poland again recorded the lowest inflation and simultaneously has the highest rate of unemployment.

In 2006 Q3, the annual rate of growth of the Polish economy rose by 0.2 percentage point to 5.6%. The growth was driven mainly by a surge in investment of over 18% and by a sharp increase in household consumption of almost 6% as a result of an improved situation on the labour market and strong growth in real wages. The high investment and consumer demand fostered a rapid expansion in industrial production, whose growth rate exceeded 12% in Q3 and Q4. The high GDP growth rate generated a year-on-year decrease in unemployment of almost 2 percentage points.

Chart III.5
In 2006 Q4, HUF and SKK appreciated sharply while PLN strengthened only weakly
(average for January 2005 = 100)



Although the rapid expansion of the Polish economy brought about a modest increase in consumer price inflation, which in November rose to 1.4%, the increases in the price level fluctuated at, or just below the lower boundary of the NBP's inflation target band. Core inflation also remained below 1.5%. This subdued price growth was due to appreciation of the zloty and rapid growth in labour productivity. High unemployment, which did not fall below 15% until October, contributed to the non-inflationary wage situation. Given the weak inflation, appreciating exchange rate and growing labour productivity, the Polish central bank did not raise its key rate in Q4, leaving it at 4% for the ninth consecutive month despite the accelerating GDP growth.

Annual GDP growth in Hungary edged up to 4.2% in 2006 Q3 compared to the previous period. The contribution of net exports increased, whereas domestic demand fell, as austerity measures adopted in a "fiscal package" in July 2006 after the parliamentary elections led to a decline in government consumption and to a small rise in household consumption. These measures reduced government expenditure and raised taxes, regulated prices and charges for some services, and caused a decline in investment and an increase in inflation, accompanied by a fall

in real wages. Industrial output growth was 10.6% in October and fluctuated around 9% on average in the first ten months of 2006. This result showed that industrial production in Hungary is particularly dependent on external demand and that the fiscal measures affected it only to a limited extent. The unemployment rate rose slightly year on year in December, reaching 7.5%.

In Hungary, consumer price inflation rose slightly to 6.4% in November and core inflation increased to 4.6%. After raising its key rate in October by 0.25 percentage point to 8%, the MNB decided to leave the rate unchanged in December. Despite the accelerating inflation and the outlook for a further rise in 2007, the central bank's decision was largely based on the appreciation of the forint, whose value against the euro rose by roughly 7% in Q4 compared to the previous quarter, and on the structure of GDP growth, which, given the decline in domestic demand, was driven mainly by exports. The MNB did not rule out the possibility of a future increase in interest rates. In its decisions, the bank will take into account core inflation, wages and the exchange rate of the forint in particular.

Annual economic growth in Slovakia reached an extraordinary 9.8% in 2006 Q3, mainly thanks to large additions to inventories linked with expanding production in the car and electrical engineering industries. The growth was also due in large measure to increases in fixed investment and household consumption, which rose by more than 6%. Despite high export growth of 23%, the contribution of net exports to GDP growth was insignificant, owing to 25% growth in imports. Industrial production rose by 11% in October, thanks mainly to growth in the car and electrical engineering industries. The high economic growth fostered a year-on-year rise in employment of 3.5% and a decline in the unemployment rate of 1.8 percentage points.

Consumer price inflation in Slovakia rose by 0.5 percentage point to 4.3% in November, owing to growth in gas and food prices. Conversely, producer price inflation decreased in December for the fifth consecutive time, falling to 5.6%. Despite the higher CPI growth and very robust economic growth, the NBS did not raise its key rate in December, opting to leave it at 4.75%. Although the central bank viewed a monetary policy tightening as necessary in order to ensure fulfilment of its inflation target, this tightening materialised via a significant appreciation of the koruna-euro exchange rate, which allowed the bank to leave its monetary policy rate unchanged. Thanks to the high economic growth, the Slovak government operated in 2006 with a deficit preliminarily estimated at 2.5% of GDP.

III.2 THE MONETARY CONDITIONS

According to CNB's calculations, the settings of the real monetary conditions in 2006 Q4 can be characterised as roughly neutral. The interest rate component was slightly tight, whereas the exchange rate component was on average neutral to very slightly easy.[7] The evolution of the two components of the monetary conditions in 2006 Q4 is described in more detail below.

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

III.2.1 Interest rates

The CNB left its key interest rates unchanged in 2006 Q4. With effect from 29 September, the 2W repo rate is 2.5%, the Lombard rate 3.5% and the discount rate 1.5%. Market interest rates did not remain stable, however. During October they continued to move around the levels recorded at the end of September, when the CNB tightened its monetary policy. At the end of October the rates started to fall gradually. This was mostly due to the strong exchange rate of the koruna and the published inflation figures, which were lower than expected. The decline in interest rates was also fostered by comments by Bank Board members on the settings of key interest rates. These comments sent out a message that, owing to the strengthening koruna, the CNB would probably raise its key interest rates later and to a lesser extent.

At the press conference following the November Bank Board meeting (on 30 November), the risks of the current macroeconomic forecast were described as being on the downside. In late November and early December, the appreciation of the koruna's exchange rate accelerated and market interest rates fell faster in line with this trend. Rates with maturities over one year were also flat or falling, despite the fact that such rates were increasing on foreign markets. The GDP figures had a neutral effect on rates, confirming continuing strong economic growth and only moderate demand-pull inflationary pressures. Interest rates decreased by up to 0.3 percentage point overall in 2006 Q4, depending on maturity. PRIBOR spot quotations and FRA forward quotations at the end of 2006 indicated that financial market participants expected a further monetary policy tightening to occur in 2007 Q2 at the earliest.

At the start of the period under review, the PRIBOR yield curve shifted to a higher yield level over its entire length (in response to the September rise in the CNB's key rates). Rates at the longer end of the yield curve gradually decreased, however, and, as a result, its positive slope decreased slightly as well. The spread between the 1Y PRIBOR and the 2W PRIBOR was 0.38 percentage point in December. Unlike the money market yield curve, the IRS curve shifted to a lower level over its entire length. The slope of the curve remained positive. In December, the average 5Y-1Y spread was 0.54 percentage point and the 10Y-1Y spread 0.82 percentage point.

The evolution of the interest rate differential on the money market (PRIBID/CZK-LIBOR/EUR or LIBOR/USD) was affected by changes in key rates and movements in interbank market rates. The Fed left its key O/N rate at 5.25% and the ECB raised its refinancing operations rate in two steps by a total of 0.50 percentage point to 3.50% during Q4. The interest rate differential vis-à-vis euro and dollar rates was negative at all maturities.

Nine auctions were held on the primary government bond market, with original maturities of 3Y-30Y and a total volume of CZK 62.1 billion. All auctions met with sufficient interest, including the first-ever 30Y maturity bond. Owing to the high demand for this bond, the Ministry of Finance decided to significantly increase the volume of the issue. The high demand at the auctions, particularly from foreign investors, was one of the factors behind the falling interest rates with longer maturities. Standard & Poor's confirmed the Czech Republic's foreign currency sovereign credit rating at A-/A-2 and its koruna rating at A/A-1; at the same time it left its positive outlook unchanged. The agency's earlier warning regarding a potential downgrading of the Czech Republic's rating due to the rising public finance deficit thus did not materialise.

The evolution of interest rates on the financial market was also reflected in client interest rates. Nominal interest rates on new loans were 6.0% and rates on new time deposits 2.0% in November. Real interest rates[8] are affected not only by the

Chart III.6
The CNB left its key interest rates unchanged in Q4
(percentages)

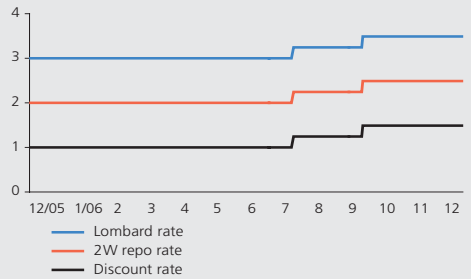


Chart III.7
Market interest rates fell somewhat in Q4
(percentages)

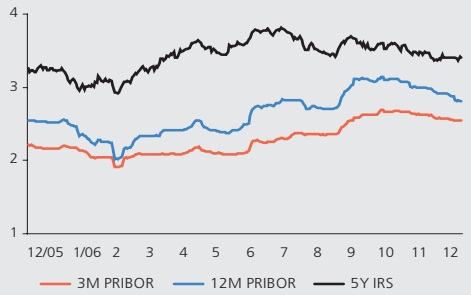


Chart III.8
The interest rate differentials of the koruna vis-à-vis the euro and the dollar fluctuated in negative values
(percentage points)

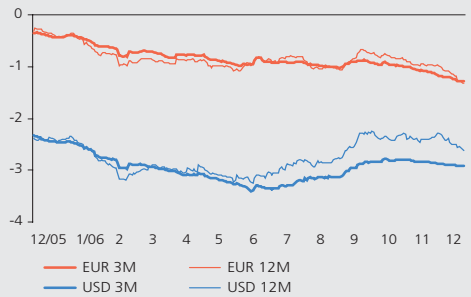
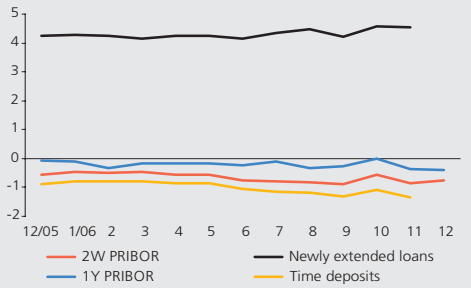


Chart III.9
Ex ante real interest rates on new loans fluctuated above 4%
(percentages)

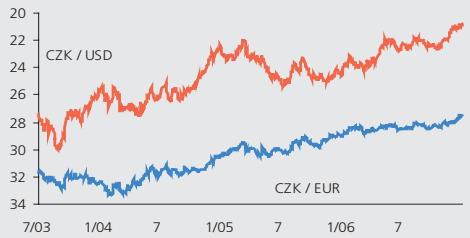


level of nominal rates, but also by movements in inflation expectations. Expected consumer price indices have long been higher than expected industrial producer price indices. This fact is reflected in the levels of the individual real interest rates. Real rates on new loans were 4.5% in November, while real rates on time deposits were -1.3%.

III.2.2 The exchange rate

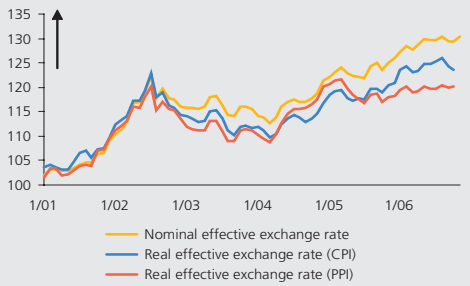
The average exchange rate of the koruna against the euro was CZK 28.05/EUR in 2006 Q4, which represents a year-on-year appreciation of 4.3% (and a quarter-on-quarter appreciation of 1.0%). The appreciation trend, temporarily interrupted in August and September 2006, probably owing to substantial foreign exchange purchases for dividend payments, resumed at the end of September; the koruna then appreciated throughout virtually the whole of Q4. This renewed koruna appreciation tendency was chiefly due to positive financial market sentiment about the Central European region. Appreciation was apparent for all currencies, but with mixed intensity, reflecting the specific economic conditions in each country. The Czech koruna (along with the Polish zloty) appreciated the least. Of the fundamental factors, the renewed upward trend in the trade surplus may have contributed to the appreciation of the Czech koruna. In 2006, the average exchange rate was CZK 28.34/EUR, which represents an average year-on-year appreciation of the koruna of 4.8%.

CHART III.10
The koruna's appreciation against the euro and the dollar accelerated in 2006 Q4



In 2006 Q4, the average exchange rate of the koruna against the dollar was CZK 21.8/USD, which represents a year-on-year appreciation of 11.7% and a quarter-on-quarter appreciation of 2.1%. In 2006, the average level was CZK 22.6/USD. The dollar depreciated slightly on world markets in 2006 Q4 (fluctuating most of the time between USD 1.3 and 1.33/EUR). Owing to the modest depreciation of the dollar and the appreciation of the koruna, the koruna-dollar exchange rate was around CZK 20.75/USD at the end of 2006. The koruna has thus strengthened by almost 50% against the dollar in six years (the average exchange rate in October 2000 was CZK 41.12/USD).

CHART III.11
The year-on-year appreciation of the nominal effective exchange rate picked up in 2006 Q4
(year 2000 = 100)



The nominal effective exchange rate of the koruna strengthened by 4.5% year on year in 2006 Q4. Compared to the previous quarter, the appreciation increased by around 0.9 percentage point. This increase was largely a result of the koruna's appreciation against the euro and the dollar. Owing to the difference in price developments, the year-on-year appreciation of the real effective exchange rate deflated by the CPI slackened. In October and November, it appreciated by 3.6% year on year. A slower pace of year-on-year appreciation was recorded by the real effective exchange rate deflated by the PPI (2.5%).

III.3 THE BALANCE OF PAYMENTS

III.3.1 The current account

In 2006 Q1–Q3, the current account ended in a deficit of CZK 97.5 billion (i.e. 4.1% of GDP). In year-on-year terms this meant a significant rise in deficit (of CZK 56.5 billion). This was due to a deterioration in all items except the trade

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

Table III.1
The current account deficit increased, mainly as result of a deterioration of the income balance
(CZK billions)

	I-III/03	I-III/04	I-III/05	I-III/06
A. Current account	**-94.5**	**-125.3**	**-41.0**	**-97.5**
Trade balance	-36.1	-15.4	39.9	39.7
Balance of services	10.4	11.2	17.1	10.5
Income balance	-79.7	-125.3	-113.7	-142.7
Current transfers	10.9	4.2	15.7	-5.0
B. Capital account	**-0.1**	**4.1**	**2.8**	**3.1**
C. Financial account	**89.9**	**104.3**	**123.1**	**77.1**
Direct investment	80.3	84.4	209.2	84.5
Portfolio investment	-55.4	62.7	-53.5	-51.9
Financial derivatives	2.3	2.8	-2.1	-1.3
Other investment	62.6	-45.5	-30.5	45.9
D. Errors and omissions	**15.1**	**23.1**	**4.7**	**19.4**
E. Change in reserves	**-10.4**	**-6.3**	**-89.6**	**-2.1**
(- = increase)				

Chart III.12
The annual moving total of the trade surplus increased in 2006 Q3
(CZK billions)

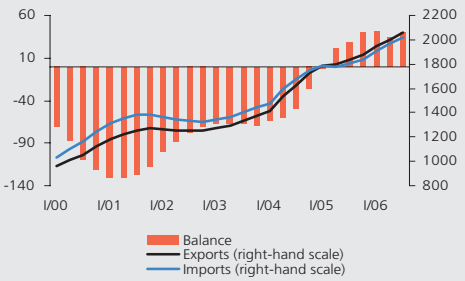
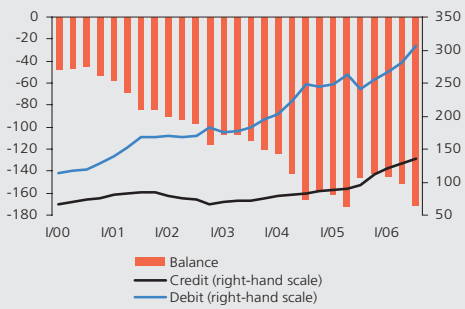


Chart III.13
The annual moving total of the income deficit increased in 2006 Q3
(CZK billions)



balance, which remained practically unchanged in year-on-year terms. The deterioration was mostly due to the income balance. The current account deficit consisted mostly of the income deficit, reflecting above all high FDI earnings of non-residents. The current transfers deficit also contributed to a small extent.

In 2006 Q1–Q3, the trade surplus was CZK 39.7 billion (compared to CZK 39.9 billion in the same period of 2005). The main reason for the halt in the trend of year-on-year improvement in the trade balance observed since 2000 was a sharp year-on-year rise in prices of raw materials on world markets, most notably oil, natural gas and non-ferrous metals. To a lesser extent, the trade balance was also adversely affected by increasing domestic demand. Exports grew by 14% and imports by 14.2% year on year in 2006 Q1–Q3. The terms of trade deteriorated by 2.8%. Export prices fell by 1.2% year on year, owing mainly to the koruna's year-on-year appreciation. By contrast, import prices increased by 1.6%, mostly due to rising prices of raw materials.

The trade balance improvement was again due to developments in the SITC 7 category (machinery and transport equipment). The surplus in this category increased by CZK 55.1 billion year on year, thanks mainly to a rise in the surplus on road vehicles. This effect was, however, moderated by a further widening (of CZK 33.5 billion year on year) of the deficit on SITC 3 (mineral fuels). (About 90% of this was due to year-on-year growth in oil and natural gas prices, while the rest was due to an increase in the physical volume of oil imports.) A decline of CZK 10.7 billion in the surplus on SITC 6 (manufactured goods) was another factor worsening the trade balance (chiefly due to rising prices of imported non-ferrous metals). From the geographical perspective, the trade surplus with the EU continued to increase – by CZK 42 billion year on year to CZK 243 billion. An improvement of about CZK 7 billion in the trade balance with the Ukraine (to a surplus of around CZK 6 billion) came as quite a surprise. By contrast, a deterioration continued to be seen in trade with China (of CZK 22 billion to CZK 79 billion) and Russia (of CZK 17 billion to CZK 51 billion). In Q3, the trade balance ended in a surplus of CZK 5.1 billion. The year-on-year improvement of CZK 5.9 billion was due primarily to the absence of a one-off import of military aircraft of the same value realised in 2005.

The balance of services showed a surplus of CZK 10.5 billion. In year-on-year comparison, however, the surplus decreased by CZK 6.6 billion. The year-on-year decrease in the services surplus was affected most strongly by a fall in receipts from direct investment services provided by corporations. The substantial rise in receipts recorded in 2005 seems to have been a one-off phenomenon. In Q3, however, the year-on-year deterioration on the services balance virtually halted thanks to a rise in receipts from other services (telecommunications, computer and technical services). This may have been connected with favourable changes on the supply side of the economy associated with FDI inflows into the services sector.

The income balance showed a deficit of CZK 142.7 billion in Q1–Q3, representing a year-on-year deterioration of CZK 29.0 billion. This was chiefly due to the estimated balance of reinvested direct investment earnings of CZK 72.7 billion, which was CZK 16.3 billion higher than a year earlier. In addition, non-residents' dividends from direct investment increased (by CZK 15.6 billion year on year to CZK 56.6 billion). The rise in the total income deficit was counteracted by faster growth of the surplus on income on other investment, in particular income on the CNB's foreign exchange reserves and interest income of commercial banks on foreign deposits.

Current transfers recorded a deficit of CZK 5.0 billion, deteriorating by CZK 20.7 billion year on year. The year-on-year deterioration on current transfers was largely due to base effects connected with a one-off transaction relating to damages paid to

ČSOB by the Slovak Republic (CZK 12.6 billion). Another major factor was a year-on-year decline of about CZK 3.5 billion in direct compensation from the EU budget to the state budget. (This decline was, however, fully offset by an increase in income from EU funds, but these revenues are recorded on the capital account.)

III.3.2 The capital account

In 2006 Q1–Q3, the capital account recorded a surplus of CZK 3.1 billion (a year-on-year increase of CZK 1.3 billion). The size of the surplus was quite strongly moderated by the inclusion of a write-off of a claim against Iraq to expenditure (roughly CZK 4 billion). Annual growth in revenues totalled roughly CZK 5.3 billion and was associated primarily with higher income from EU funds and emission allowance trading.

III.3.3 The financial account

In 2006 Q1–Q3, the financial account showed a surplus of CZK 77.1 billion, or 3.2% of GDP (compared to a surplus of CZK 123.1 billion in the same period of 2005). The financial account surplus consisted of direct investment and other investment. The main reason for the sizeable annual decrease in the financial account surplus was a moderation of the net inflow of direct investment, resulting from an absence of major sales of assets to non-residents in 2006. To a lesser extent it was due to a rise in residents' interest in direct investment abroad. Counteracting the decline in the financial account deficit was a significant change in other investment flows, with capital outflow being replaced by capital inflow.

Direct investment ended in a surplus of CZK 84.5 billion, down by CZK 124.7 billion from a year earlier. The total FDI inflow amounted to CZK 110.4 billion and was about half that recorded in 2005. The largest FDI item was reinvested earnings of non-residents (CZK 81.7 billion), whose estimated volume increased by CZK 23 billion year on year. The annual moderation of the overall FDI inflow was chiefly due to base effects relating to large sales of assets to non-residents in 2005 amounting to more than CZK 140 billion (Český Telecom, Nova, Unipetrol). To a lesser extent it was due to a one-off decrease in investment in equity capital in 2006 owing to an accounting operation decreasing the equity capital of a major foreign-owned corporation in the Czech Republic. Adjusted for these effects, the capital inflow increased slightly in year-on-year terms thanks to higher foreign capital inflow in Q3. With regard to industries, the foreign capital inflow (about CZK 40 billion) was channelled primarily into trade and real estate. By territory, the biggest investors were the United Kingdom, the Netherlands, Cyprus and Luxembourg. Czech direct investment abroad doubled year on year, mainly thanks to acquisitions by ČEZ and the estimated rise in reinvested earnings, and amounted to CZK 26.0 billion (compared to an outflow of CZK 12.9 billion in the same period of 2005).

The net outflow of portfolio investment in 2006 Q1–Q3 was CZK 51.9 billion. In year-on-year terms this meant an insignificant decrease in outflow (of CZK 1.6 billion). This decrease was quite surprising, since it occurred in the context of a widening negative interest rate differential of the koruna vis-à-vis major world currencies and a pronounced year-on-year decline in government bond issuance on foreign markets, from CZK 30 billion to CZK 6 billion. Portfolio investment outflow showed a slight year-on-year decrease of CZK 2.3 billion to CZK 59.9 billion (with a roughly 1:1 ratio of shares and debt securities). The inflow of capital under portfolio investment (CZK 7.9 billion) remained virtually unchanged from a year earlier. However, it showed a marked change in structure. The inflow of debt capital decreased strongly (owing primarily to the aforementioned lower government bond

Chart III.14
Firms registered in the UK were the largest foreign investors in the Czech Republic in 2006 Q1-3

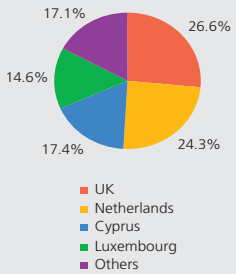
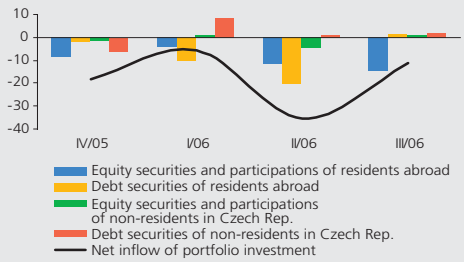


Chart III.15
The net portfolio investment outflow decreased in 2006 Q3
(CZK billions)



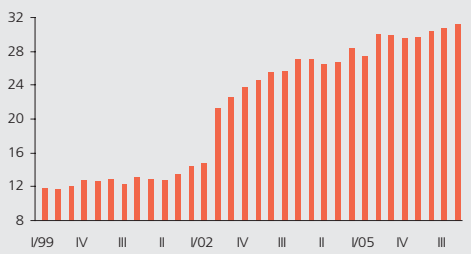
issuance on foreign markets), but this decrease was offset by a near halt in the outflow of non-residents' capital from the Czech stock market.

Financial derivatives generated a CZK 1.3 billion decrease in the financial account surplus. Their significance is still relatively low, however.

Other investment recorded a net capital inflow of CZK 45.9 billion in 2006 Q1–Q3 (compared to an outflow of CZK 30.5 billion in the same period of 2005). The year-on-year change of more than CZK 70 billion was due exclusively to a change in capital flows via the banking sector (a strong outflow being replaced by an inflow). The net capital inflow via the banking sector amounted to CZK 29.3 billion in the period under review. Apart from the banking sector, the net capital inflow was due also to the government and the corporate sector. Net borrowing abroad by the corporate sector amounted to CZK 8.9 billion. In Q3 alone, however, net credit to the corporate sector fell by more than CZK 15 billion. This was partially due to the substitution of existing loans to ČEZ by a bond. Foreign funds obtained by the government sector amounted to CZK 11.3 billion. In year-on-year terms, however, this meant a decrease in drawings on foreign funds of more than one-half, owing to a decline in the volume of de-blocking operations (the completion of the repayment of Russian debt) and particularly to lower borrowing from the EIB.

The CNB's international reserves decreased by CZK 35.3 billion to CZK 653.1 billion in 2006 Q4. This was due mostly to exchange rate differences. In dollar terms, the reserves rose by USD 0.6 billion to USD 31.3 billion in the same period.

Chart III.16
The CNB's international reserves increased in dollar terms in 2006 Q4
(USD billions)



III.4 MONETARY DEVELOPMENTS

Money supply growth increased in 2006 Q3. The rise in the CNB's key interest rates had yet to pass through into the structure of the money supply. The strong demand for highly liquid money persisted, in line with the economic cycle. The favourable financing conditions fostered further growth in credit to corporations and households. The money supply growth had yet to indicate any major inflation pressures in the medium run.

III.4.1 Money

Annual M2 growth was higher in Q3 and October than in Q2, and slowed slightly to 9.0% in November. The annual rate of growth of M2 adjusted for exchange rate movements and other non-transaction effects followed a similar pattern and was 9.6% in November. The relatively high money supply growth was due to the low interest rate levels and was consistent with nominal GDP growth (see Chart III.17). The M2 growth was fostered by growth in loans to corporations and households and in net credit to the government.

The higher M2 growth was again due to the highly liquid money included in M1. Annual M1 growth was 15.2% in November (see Table III.2). Overnight deposits and currency in circulation increased. By contrast, quasi money slowed the M2 growth, chiefly owing to a decline in deposits with agreed maturity. Growth in deposits redeemable at notice increased. Its gradual upswing in the last two years is connected with advantageous rates of interest on building society deposits.

The share of M1 in M2 increased further in Q3, confirming the impact of the low interest rate level, which implies low opportunity costs of holding money. The July and September increases in the CNB's key interest rates led to rising interest rates on deposits with agreed maturity of up to one year and deposits redeemable at

Chart III.17
Money supply growth was in line with the economic cycle
(annual percentage changes)

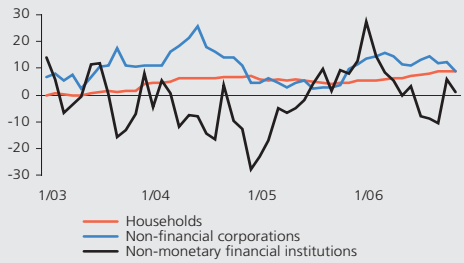
Table III.2
The highly liquid money included in M1 contributed to M2 growth
(quarterly averages and end-of-month stocks; annual percentage changes)

	II/06	III/06	10/06	11/06	Share in M2, % 11/06
M1	14.6	16.5	16.4	15.2	58.0
Currency in circulation	10.4	11.4	11.1	11.2	13.6
Overnight deposits	16.1	18.2	18.1	16.4	44.4
M2-M1 (quasi money)	1.5	0.6	2.1	1.5	42.0
Deposits with agreed maturity	-3.2	-4.9	-3.6	-4.3	29.9
Deposits redeemable at notice	15.1	19.3	20.5	19.6	11.6
Repurchase agreements	66.5	5.4	19.2	14.0	0.5
M2	8.4	9.0	9.9	9.0	100.0

notice. Interest rates on overnight deposits tended to be flat, since they generally respond more weakly to increases in the CNB's key rates. The rise in interest rates on deposits with agreed maturity and deposits redeemable at notice was reflected in widening spreads between these rates and rates on overnight deposits. This, however, has yet to affect the money supply structure.

Turning to the sector structure of deposits, the main contribution to M2 growth came from deposits of households and non-financial corporations (see Chart III.18). The gradual increase in their contribution was in line with the structure of nominal GDP growth in 2006. The growth rate of deposits of non-monetary financial institutions picked up in October; the share of these deposits in the money supply is low, however, and is usually connected with portfolio changes rather than transaction purposes. The share of koruna deposits in total deposits remained significant. The proportion of foreign currency deposits increased slightly to 10.5%, owing to foreign trade developments.

Chart III.18
Growth in deposits of households and non-financial corporations affected M2
(annual percentage changes)



III.4.2 Credit

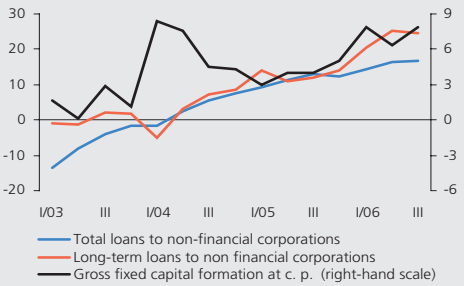
The relatively strong growth in loans to corporations and households continued into Q3 and on into October and November (see Table III.3). Loans to households again accounted for more than half of the growth in loans. The proportion of koruna loans was significant.

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

	II/06	III/06	10/06	11/06	Share in total loans, % 11/06
Non-financial corporations	16.2	16.9	16.8	20.6	49.9
Loans up to 1 year	13.2	11.1	11.8	12.6	19.1
Loans over 1 year and up to 5 years	9.1	15.6	11.8	17.4	12.2
Loans over 5 years	25.4	24.6	26.6	32.7	18.6
Households	32.4	32.2	31.1	30.5	41.0
Consumer credit	28.5	27.5	26.9	25.8	8.3
Loans for house purchase	34.2	33.7	33.6	33.2	28.4
Other loans	28.8	26.1	23.2	23.1	4.3
Non-monetary financial institutions	5.5	2.2	-0.8	-5.4	9.1
Total loans	20.7	20.8	20.1	21.3	100.0

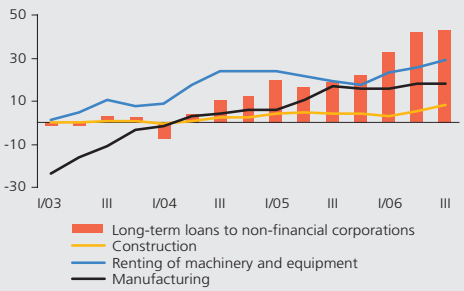
The higher growth in loans to non-financial corporations (20.6% in November 2006) was linked with the favourable trend in economic activity, the low level of interest rates and the positive lending attitude of MFIs. Long-term loans grew the fastest, in line with gross fixed capital formation (see Chart III.19). The increase in loans was driven mainly by loans to the machinery and equipment rental sector, manufacturing and, to a lesser extent, construction, i.e. industries which were also major contributors to the growth in investment (see Chart III.20). The growth rate of lending to wholesale and retail trade, sales, maintenance and repair was also quite high, although with the exception of November it did not increase in the period under review. By contrast, loans to the construction industry saw a rise in growth. These loans include financing of housing schemes via lending to property developers. The above increase was due to rising demand for flats associated with the expected increase in the VAT rate on construction work from 5% to 19% as from 2008 and rent deregulation, which will go on gradually until 2010. According to property market experts, this resulted in rising prices of flats, with mixed intensity across individual localities.

Graf III.19
Long-term loans contributed to growth in gross fixed capital formation
(annual percentage changes)



The increase in loans to non-financial corporations in Q3 was due to loans to domestic corporations and, to a lesser extent, loans to foreign-owned corporations. To finance their economic activities, foreign-owned corporations also used their own funds and trade credits from abroad. In Q3, however, there was a slowdown in trade credit growth, caused by more intensive repayment. The higher growth rate of foreign-owned corporations' own funds was affected by increasing profits, thanks primarily to a positive export trend. However, total foreign loans to corporations, i.e. including financial loans, represented only about one-fifth of domestic loans (expressed as net annual flows), owing to higher interest rates in the euro area.

Chart III.20
Loans to the machinery and equipment rental sector contributed the most to the higher growth in loans to corporations
(annual flows; CZK billions)



Growth in loans to households stayed high, at about 32%, despite recording a slight slowdown. There was a decrease in the rate of growth of consumer credit, and to a lesser extent that of loans for house purchase. Mortgage loans again showed the fastest growth (47.9%), due to the low interest rate level (see Chart III.21), the supply of credit, the aforementioned expected increase in the VAT rate on construction work, and rent deregulation. Since the start of 2006, growth

Chart III.21
Long-term interest rates on loans for house purchase were unchanged in 2006 H2
(percentages)

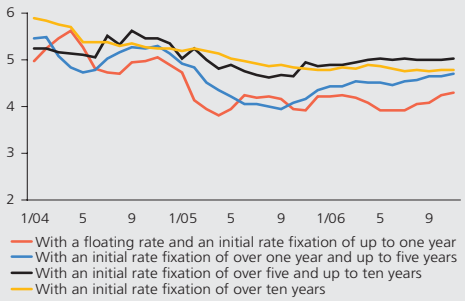


Chart III.22
Interest rates on consumer credit mostly rose
(percentages)

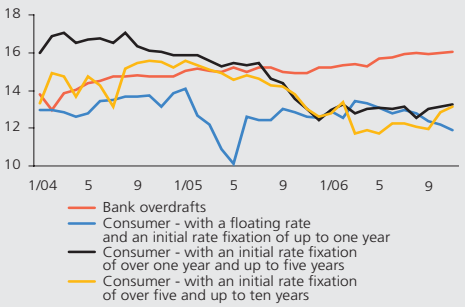


Chart III.23
Despite slowing consumer credit growth, household consumption growth stayed relatively high
(annual percentage changes)

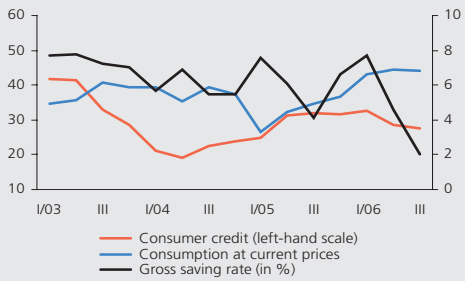
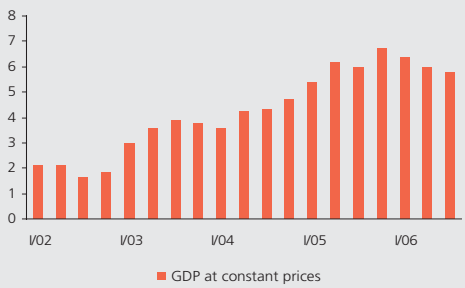


Chart III.24
Economic growth slowed in 2006 Q3, but remained high
(annual percentage changes)



in building society loans has increased further, this being associated, as in the case of mortgage loans, with higher household demand for housing. This is also suggested by growth in the number and approximate value of building permits issued for residential buildings in January–October 2006. As for the structure of loans for house purchase, growth was recorded for loans with long-term maturities, which became generally more available to lower income households, and for loans with a long rate fixations. The latest available data are for 2005, however, when roughly two-thirds of loans were provided to households in the two highest income categories (see the July 2006 Inflation Report).

The slowdown in consumer credit growth continued into Q3. This was true both for bank overdrafts (connected usually with debit balances on current accounts and with credit cards) and traditional consumer credit. The lower consumer credit growth recorded in 2006 may have been affected by higher financing costs (see Chart III.22). Growth in consumer credit with long maturities slackened, but such loans remained the fastest growing. Consumer credit is characterised by a higher proportion of loans with short-term maturities compared to loans for house purchase (about 27%, including loans from other financial intermediaries, i.e. hire-purchase and financial leasing companies), which makes them more risky in general. Despite the slowing consumer credit growth, the growth rate of household consumption was still relatively high (see Chart III.23). It was financed by gross disposable income growth and a sharp decline in the gross saving rate.

The growth in loans to households generated a further rise in the ratio of total household debt to GDP, from 18.6% in Q2 to 19.3% in Q3. The debt ratio rose for MFI loans, which accounted for four-fifths of total household indebtedness. The rest was due to loans from other financial intermediaries. In the euro area, the ratio of total household debt to GDP increased to 58.7% in Q3.

III.5 DEMAND AND OUTPUT

The rapid economic growth continued into 2006 Q3, fluctuating around 6% for the sixth consecutive quarter. Since the start of 2006, however, its annual growth rate has been steadily easing. According to the CZSO's latest estimates, annual GDP growth was, at 5.8%, 0.2 percentage point lower than in Q2. By the CNB's estimation, the economy has been slightly exceeding the potential, non-accelerating inflation level of output since 2005 Q4.

In 2006 Q3, the GDP structure confirmed the changes in the contributions of the individual expenditure components to economic growth visible since the beginning of 2006. Whereas in 2005 GDP growth was driven mostly by foreign trade, since 2006 Q1 it has been mostly due to expanding domestic demand. In 2006 Q3, domestic demand accounted for almost 90% of GDP growth (see Chart III.25). Its relatively high contribution was most affected by gross capital formation, driven by increasing inventories and growing fixed investment. The continuing rise in fixed investment was consistent with the current phase of the business cycle and was fostered above all by foreign capital inflows, easy monetary policy in the recent past and favourable growth in corporations' own funds in the previous period. As in the previous two quarters, the contribution of household consumption was higher than that of fixed investment, accounting for roughly one-third of the total GDP growth. Government consumption was the only component to make no contribution to economic growth. Although the contribution of the external sector was relatively low, real exports grew quickly, testifying to the continuing strong export performance of the Czech economy. However, export growth was only slightly faster than import growth, which was greatly affected by a pronounced increase in domestic demand.

On the supply side of the economy, the largest contributor to GDP growth was manufacturing, which had seen major structural changes in the previous period. The contributions of the services and construction sectors were again less significant in 2006 Q3. Gross value added in agriculture decreased year on year.

III.5.1 Domestic demand

The rate of growth of final consumption expenditure slackened in 2006 Q3, falling by 0.3 percentage point to 2% compared to Q2. Its annual growth was driven largely by consumption expenditure of households, which rose by 4%. In 2006 Q3, total domestic demand growth was again mostly due to sizeable year-on-year growth in gross capital formation, which amounted to 13.6%. Inventories increased in all the main categories, including work-in-progress, which was affected in particular by work-in-progress in the construction industry. Growth in fixed capital expenditure picked up further, reaching 7.2%.

Consumer demand

In the first three quarters of 2006, household consumption rose at a relatively stable rate of around 4%, the highest level recorded since 2004. Its real growth was up by more than one percentage point on 2005. This was in line with the results of a CZSO survey, which indicated that consumer confidence of households had been strong since the start of 2006, reaching historical highs in some months. The increasing household spending was largely concentrated on purchases of durable goods. The biggest spending increases in the high-weight household consumption categories were recorded for clothing and footwear and household equipment (up by 13.4% and 11.2% respectively year on year). Spending on leisure and culture also saw a large rise (of 7.2%).

Gross disposable income remained the main source of financing of households' rising final consumption expenditure in 2006 Q3. However, its annual nominal growth rate decreased compared to 2006 Q2, to 4.4%. Owing to higher annual inflation its real growth slowed even more, reaching just 1.6%. Weaker growth was registered in all major components of household income. The largest effect came from a further slowdown in income from wages and salaries (to 6.3%), which is the main component of current incomes of households (for more details see section III.6 *The labour market*). Property income, gross operating surplus and other current transfers also grew more slowly. Only social benefits maintained the relatively rapid annual growth recorded in the previous quarter (6.6%).[9] The slowdown in gross disposable income growth was due, among other things, to interest expenditure, reflecting increasing loan costs.

Households' gross disposable income again grew more slowly than their consumption expenditure in 2006 Q3. Chart III.26 shows that this difference in the growth rates of the two variables widened further compared to the previous quarter. Under these circumstances, households financed their rising consumption expenditure by saving less from their current income and by borrowing. This was confirmed by a year-on-year decline of CZK 7.7 billion in gross saving, which fostered a reduction in the saving rate to the lowest level recorded since the beginning of the time series in 2002. Consumer credit growth moderated in Q3, but remained in double figures (see section III.4 *Monetary developments*).

Chart III.25
Domestic demand accounted for most of the GDP growth in 2006 Q3
(contributions in percentage points, source: CZSO)

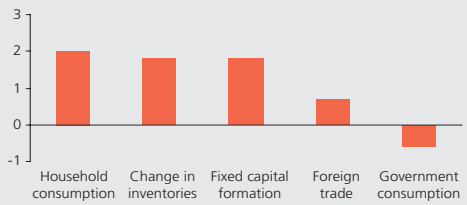
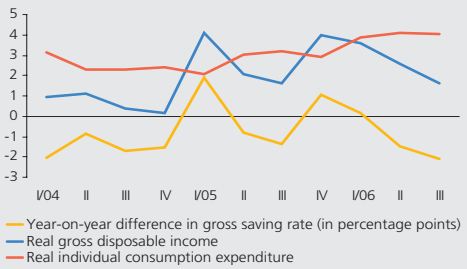


Table III.4
Gross capital formation contributed the most to domestic demand growth
(annual percentage changes; CZK billions)

	2005 Q4	2006 Q1	2006 Q2	2006 Q3
GROSS DOMESTIC PRODUCT	6.7	6.4	6.0	5.8
FINAL CONSUMPTION EXPENDITURE	2.0	3.4	2.3	2.0
of which:				
Household consumption	2.9	3.9	4.1	4.0
Government consumption	-0.1	2.4	-1.8	-2.6
Non-profit institutions serving households	8.6	4.5	5.5	8.4
GROSS CAPITAL FORMATION a)	4.8	7.6	16.2	13.6
Gross fixed capital formation	3.2	6.1	6.7	7.2
NET EXPORTS OF GOODS AND SERVICES (CZK billions)	-19.8	8.9	-9.8	-12.6
Imports of goods and services	4.9	16.3	11.0	10.6
Exports of goods and services	10.1	18.5	10.7	11.4

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

Chart III.26
Household consumption has been rising at a stable rate of around 4% since the start of 2006
(annual percentage changes)



9 i.e. social benefits other than social transfers in kind. Their annual growth of 6.6% was due to social security payments (up by CZK 6.9 billion year on year) and pensions (up by CZK 4.8 billion).

Chart III.27
The consumer confidence indicator remained high in 2006 Q3
(2005 average = 100)

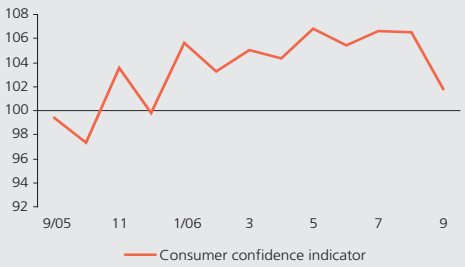


Chart III.28
Annual growth in fixed investment rose further in 2006 Q3
(annual percentage changes; constant prices)

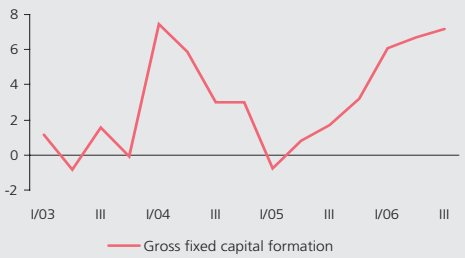


Chart III.29
Technological investment was again the biggest contributor to investment growth in 2006 Q3
(annual changes in CZK billions; constant prices)

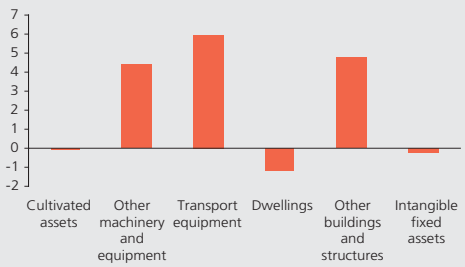
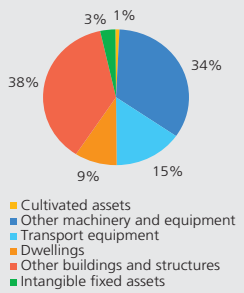


Chart III.30
The shares of technological and construction investment in the investment structure were roughly equal
(percentages; constant 2000 prices; 2006 Q3)



Households' ongoing higher propensity to consume, amid relatively slower growth in wage income, was probably due to numerous factors – not only the persisting favourable borrowing conditions, including the easy interest rate component of the monetary conditions in the recent past, but also higher demand for household equipment connected with new housing construction and the long-running year-on-year decline in prices of durable consumer goods (see section II.1 *Past inflation developments*).

Investment demand

A further pick-up in growth in fixed capital investment in 2006 Q3 indicated continuing dynamic investment activity in the economy (see Chart III.28). Annual growth in gross fixed capital formation was 0.5 percentage point higher than in Q2, reaching an impressive 7.2%. At 25.1%, the ratio of fixed investment to GDP remained relatively high.

As regards the structure of investment by kind, there were no major changes compared to 2006 Q2. Annual investment growth was again driven mainly by technological investment[10], as illustrated in Chart III.29. Very rapid growth was again recorded for investment in transport equipment (up by 24.9% year on year), whose contribution to the total annual investment growth was the biggest, as in Q2. High growth of around 7% also continued in investment in other machinery and equipment, which was mostly channelled into investment projects implemented with the aid of foreign capital.

In 2006 Q3, the contribution of construction investment to total annual investment growth was again much lower than that of technological investment, despite relatively strong growth in construction activity. One of the reasons was a sizeable increase in the number of buildings under construction, reflecting the strong demand for construction work and problems with completing buildings.[11] These factors probably contributed to the continuing decline in investment in dwellings, whereas investment in other buildings and structures maintained the relatively high growth rate recorded in Q2 (6.9% year on year). Overall, then, the structure of investment showed only partial changes in 2006 Q3. The largest investment volumes were channelled into machinery and equipment and other buildings and structures (around one-third each). The share of investment in transport equipment was only 15%, despite having recorded very dynamic growth since the start of 2006. Investment in dwellings accounted for 9% (see Chart III.30).

According to partial indicators[12], the largest contributors to the total investment growth in 2006 Q3 were probably non-financial corporations and the government. Continuing investment growth in the non-financial corporations sector, accounting for about 60% of total investment, was indicated above all by rapid annual growth in the acquisition of intangible and tangible fixed assets by large corporations.[13] The dominant share of foreign-owned corporations in total investment by large corporations, especially in machinery and equipment and non-residential buildings, also indicated a close link between such investment and foreign direct investment. According to partial indicators, investment also kept on rising in small and medium-sized enterprises with 20 to 99 employees. Investment in the non-financial

10 Technological investment comprises machinery and equipment and transport equipment.
11 This was due to a lack of specialised workers.
12 The CZSO publishes data on the latest investment structure developments only by kind, not by economic sector.
13 Corporations with 100 employees or more.

corporations sector was fostered not only by foreign capital inflows, but also by the relatively low level of interest rates, the favourable evolution of own funds, and current and expected demand.

The government's contribution to total investment growth in 2006 Q3 was also probably quite significant. This was suggested in particular by a very large annual increase in capital expenditure (of 32.4%), following a stagnation in Q2. By contrast, household investment in housing fell for the second consecutive quarter (by 6%). One of the main reasons for this was probably the aforementioned problem of an increasing number of flats under construction, as indicated by their high annual growth of 17.2% in the first three quarters of 2006. Relatively high annual growth in the number and approximate value of building permits for residential buildings in Q3 (8.8% and 5.2% respectively) meanwhile suggested that the decline in the number of housing completions was transitory.

Government demand

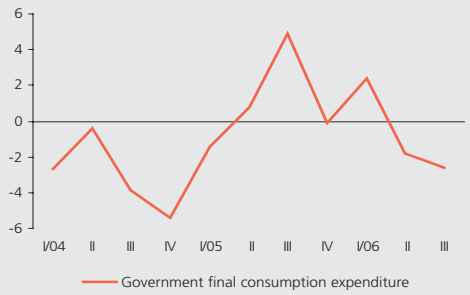
General government expenditure on final consumption fell by 2.6% year on year in 2006 Q3. As in the previous quarter, this was due mainly to base effects[14] and, to a lesser extent, to subdued growth in government consumption at current prices, which stood at 1.3%.

Government demand was the primary factor affecting the state budget performance in the period under review. According to data for 2006 Q3[15], the state budget ended in a deficit of CZK 6.2 billion, a deterioration of CZK 28.2 billion compared to the same period a year earlier. This was due to a comparatively rapid increase in state budget expenditure (of 13.5% year on year) and a decline in total budget revenue of 1.5%.

The decline in state budget revenue in 2006 Q3 was chiefly a result of a tax revenue shortfall. Collection of corporate income tax decreased in particular (by 28% year on year), but personal income tax revenues were also down (by 2% year on year). This was due not only to a reduction in direct tax rates, but also, in the case of personal income tax, to the introduction of higher flat-rate expenditure allowances for self-employed persons and joint taxation of married couples. In addition, collection of excise duties fell by almost 27% owing to minimal revenues from excise duty on tobacco products as a result of forward buying in 2006 Q1 and Q2. The decline in tax revenues was counteracted by an upward trend in non-tax revenues, reflecting the increasing inflow of EU funds and high transfers from 2005 reserve funds. Although much higher than a year earlier, these revenues were insufficient to offset the decline in direct tax and excise duty revenue.

As in 2006 Q2, the sharp increase in state budget expenditure was due mainly to transfers to social security and health insurance funds, transfers to state funds and higher pension expenditure. Government capital expenditure, channelled mainly into investment, also recorded a significant increase in 2006 Q3. However, these expenditure items do not directly affect government consumption. By contrast, government consumption is directly affected by public wage expenditure, which grew at almost the same rate in 2006 Q3 as in the previous quarter (4.2% year on year), and by other current expenditure, which declined somewhat. An analysis of state budget expenditure in 2006 Q3 reveals that fiscal policy had a moderately

CHART III.31
The year-on-year decline in government final consumption expenditure deepened in 2006 Q3
(annual percentage changes)



14 In 2005 Q3, government consumption included a supply of military aircraft. Excluding this effect, general government expenditure rose by 1.1% year on year in real terms.

15 The figures on the state budget performance below are at current prices.

pro-growth effect overall, but government consumption per se did not make a major contribution to the rise in demand in the economy.

III.5.2 Net external demand

CHART III.32
The downward year-on-year trend in the net export deficit was renewed in 2006 Q3
(CZK billions; constant 2000 prices)

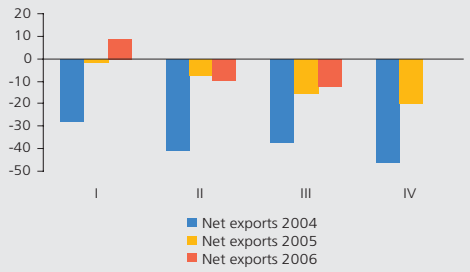
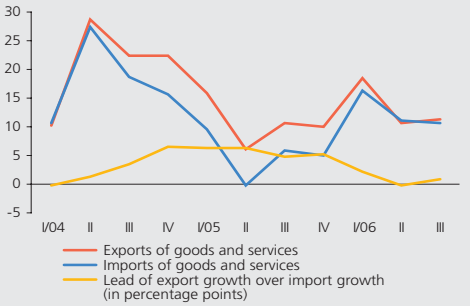


CHART III.33
Exports rose slightly faster than imports in 2006 Q3
(annual percentage changes)



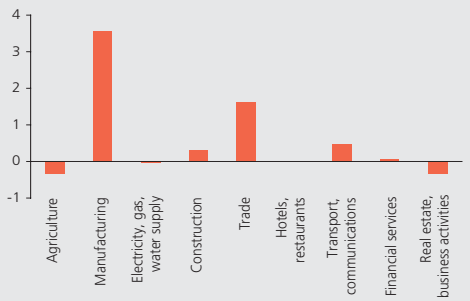
The favourable downward year-on-year trend in negative net exports of goods and services was renewed in 2006 Q3, following a temporary halt in 2006 Q2. The net export deficit improved by CZK 2.9 billion year on year (to CZK 12.6 billion) amid persisting buoyant growth in foreign trade turnover, as indicated by annual export and import growth rates exceeding 10%. However, the balance of net exports was affected most of all by a renewed lead of the growth rate of exports over imports of 0.8 percentage point. As Chart III.33 shows, export growth rose slightly to 11.4%, whereas import growth, at 10.6%, was rather more sluggish than in the previous quarter. The strong export growth confirmed the continuing robust export performance of the Czech economy. On the other hand, the only slightly slower growth in imports compared to exports suggested a relatively high import intensity of exports and output in the Czech Republic.

As in the previous two quarters, only the trade balance contributed to the year-on-year improvement in net exports. As in Q2, however, the year-on-year improvement in the trade balance was only moderate (CZK 3.7 billion). The services balance again recorded a deficit, although the growth in the deficit almost halted in 2006 Q3.

The decrease in the net export deficit was aided mainly by strong growth in goods exports, which reached 12.8% amid increased external demand. As mentioned in previous Inflation Reports, the continuing rapid growth in goods exports was due chiefly to the launching of export-oriented production facilities (especially in the car and electrical engineering industries) and transfers of production from advanced market economies to the Czech Republic. Services exports, which recorded an increase following three quarters of year-on-year decline, also contributed to the decline in the net export deficit in 2006 Q3. This rebound was connected mainly with a sharp increase in exports of other services (telecommunication, technical and computer services), which may have been linked with favourable changes on the supply side in the area of business services. By contrast, a large annual increase in goods imports of 11.8% was the primary factor fostering a deterioration in the net export deficit. This was particularly the case with investment imports and imports for intermediate consumption of corporations, owing to buoyant growth in aggregate domestic demand and to collaboration imports.

III.5.3 Output

CHART III.34
Manufacturing was the biggest contributor to the high GDP growth in 2006 Q3
(contributions in percentage points; constant 2000 prices; selected branches)



The buoyant growth in gross value added in 2006 Q3 was mostly due to manufacturing, where production continued to expand apace in some branches. The contribution of wholesale and retail trade was also high, but the contributions of other sectors to economic growth were less significant (see Chart III.34). The combined contribution of manufacturing and wholesale and retail trade to the 6.1% annual increase in gross value added was 85%. As regards other sectors, significant contributions were recorded only in transport and communications and construction. By contrast, in some branches gross value added declined year on year.

Annual growth in gross value added in manufacturing has been in double figures and rising since the end of 2004. In 2006 Q3, value added rose by a considerable 13.9% in this sector, accounting for almost 60% of total gross value added growth. As in the previous quarters, however, its high growth was accompanied by very mixed trends across the individual branches, as evidenced by the evolution of value

added in monitored large non-financial corporations.[16] According to these CZSO figures, the large increase in value added in manufacturing was concentrated in five branches which also recorded very strong output growth (see below). Within industry, value added also rose significantly year on year in mining and quarrying (23.1%, following a year-on-year decline in Q2). In the electricity, gas and water supply industry, however, the former strong growth was replaced by an annual fall. The generally fast year-on-year growth in gross value added in industry in Q3 was achieved amid a rise in the industrial production index of 8.3% in real terms, supported by higher employment and rapid productivity growth (see Chart III.35).

The main factors underlying the continuing rapid growth in industrial production were ongoing structural changes facilitated by foreign capital, and significant shifts in demand for the products of some branches. The impact of these factors was indicated in particular by a large annual increase in output at new production and assembly facilities in the transport equipment manufacturing industry (15.5% in Q3) and related branches. Manufacture of electrical and optical equipment, where many new facilities have been launched, also recorded a rapid rise in production of 14.6%. Strong two-digit growth was recorded in a further three sectors, namely manufacture of machinery and equipment, manufacture of basic metals and fabricated metal products and manufacture of rubber and plastic products. The fast production growth in these five branches was also supported by buoyant exports, as suggested by a 10.2% real rate of growth of direct exports in industry as a whole and an almost 50% share of direct export sales in total sales of industrial corporations. By contrast, falling production in some branches suggested that corporations were facing strong competition from abroad or falling demand for production in their branch.[17]

Ongoing structural changes within branches affected the structure of production by use. In particular, production of durable consumer goods continued to increase rapidly (by 13.1%) in 2006 Q3. Production of capital goods also rose significantly (by 11.7%), suggesting that part of the faster-growing domestic demand for fixed investment was probably satisfied from domestic sources. At the same time, however, production of non-durable consumer goods continued to decline (see Table III.5).

The contribution of the service sector to gross value added growth in 2006 Q3 was again lower than that of industry. Nevertheless, services still accounted for the largest proportion of gross value added in the economy.[18] As in 2006 Q2, wholesale and retail trade was the largest contributor to value added growth in services, recording the biggest increase in value added in both absolute and relative terms (11.5% year on year). The contribution of transport, where value added growth rose to 4.9%, was also important. Value added in construction rose at roughly the same rate, reflecting the continuing recovery in construction work in many areas. The value added trends in other branches were very mixed, with value added falling in more than one-third of the branches monitored.[19]

Chart III.35
The continuing growth in industrial production was accompanied by rapid productivity growth and higher employment
(annual percentage changes)

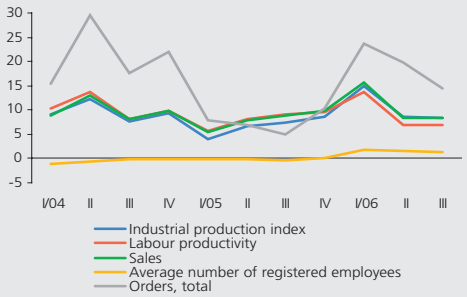
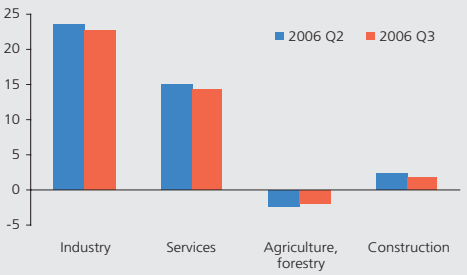


Table III.5
The rapid growth in capital goods and consumer durables production continued into 2006 Q3
(annual percentage changes)

	6/06	7/06	8/06	9/06
Industrial production, total	10.5	12	7.7	5.8
Intermediate goods	11.3	9.4	9.3	5.5
Capital goods	15.3	23.3	8.9	11.7
Consumer durables	42.5	17.7	23.7	13.1
Consumer non-durables	-0.2	0.9	-0.4	-8.4
Energy	-0.5	5.8	5.3	4.2

Chart III.36
The contribution of the services sector to gross value added growth in 2006 Q3 was again lower than that of industry
(annual changes in CZK billions; constant prices)



16 Corporations with 100 employees or more.

17 For example, production fell year on year in 2006 Q3 in the food industry, the chemical industry, the pulp, paper and paper product industry and publishing and printing.

18 In 2006 Q3, the share of services in gross value added at basic current prices was 57%.

19 In 2006 Q3, gross value added recorded year-on-year decreases in agriculture and fishing, electricity, gas and water supply, real estate and business services, education and activities of households as employers of domestic staff.

III.5.4 Financial performance of non-financial corporations [20]

The rapid expansion of pre-tax profit in large non-financial corporations continued into 2006 Q3. The rate of growth increased compared to the previous quarter, reaching 28.6%. The high profit generation was achieved amid buoyant growth in volume indicators and an improvement in profitability ratios. In 2006 Q3, annual output growth rose compared to Q2, reaching 15.9%, book value added per employee increased by 11.3% and return on equity rose by 0.8 percentage point. Nearly 70% of the monitored corporations posted profits.

In 2006 Q3, corporations generated profit amid weakening external cost pressures stemming from prices of energy-producing materials on world markets. As described in more detail in section III.7 *Import prices and producer prices*, in September this resulted in a year-on-year fall in import prices of mineral fuels and subsequently in producer prices in primary oil product processing industries. Prices of some other imported production inputs also recorded annual declines, but electricity prices and import prices of manufactured goods showed rapid year-on-year growth. Overall, these developments were reflected in a moderate decrease in the lead of cost of sales growth over sales growth observed in previous quarters. Consequently, they led to a slight decline in annual growth in the material cost-output ratio compared to Q2 (to 0.8 percentage point).

In Q3, corporations fully offset the annual increase in the material cost-output ratio with a lower personnel cost-output ratio and slower growth in write-offs. This was aided primarily by a noticeable year-on-year decrease in the personnel cost-output ratio compared to the previous quarter (of 0.9 percentage point), which was even larger in industry (1.2 percentage points). Total costs thus increased more slowly in Q3 than in the previous quarter, despite a rise in the growth rate of output. The decline in the personnel cost-output ratio was also aided by rapid productivity growth accompanied by slower wage growth, probably due in part to the employment of workers with low wage demands.

In most branches of manufacturing, however, the upturn in prices continued into 2006 Q3, suggesting that some corporations, given the favourable demand conditions, were still incorporating the rise in input costs accumulated in the previous period into their prices. The increase in prices also fostered a pick-up in profit margins, which were up by 0.8 percentage point year on year.

Profit generation was again very mixed with regard to ownership structure and across industrial branches in 2006 Q3. In foreign-controlled corporations, which account for 43% of the total assets of the non-financial corporations sector, profit generation surged by 46%, thanks largely to the export activities of these corporations. Profits in public corporations also rose significantly. By contrast, profit generation in Czech private corporations, which account for 40% of non-financial sector assets, was flat at the previous year's level.

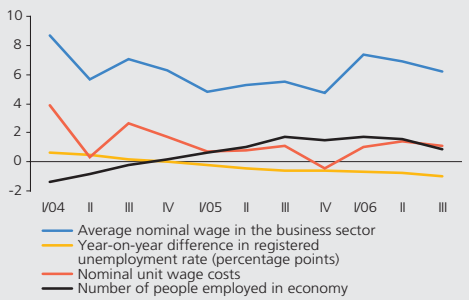
Table III.6
Profit generation increased year on year in 2006 Q3
(CZK billions; percentages)

	Q3		Annual changes	
	2006	2005	CZK billions	%
Total income	1,346.3	1,198.9	147.4	12.3
Output without profit margin	941.2	812.3	128.9	15.9
Total expenses	1,272.4	1,141.4	131.0	11.5
Cost of sales	716.8	612.7	104.1	17.0
Depreciation	546.9	505.3	41.6	8.2
Personnel costs	139.9	128.5	11.4	8.9
Book value added	271.2	237.9	33.3	14.0
Pre-tax profit	73.8	57.4	16.4	28.6

Table III.7
The higher material cost-output ratio was offset by a lower personnel cost-output ratio
(percentages; percentage points; CZK thousands)

	2006 Q3 %		Change in perc. points against 2005 Q3	
	Organisations, total	Industry	Organisations, total	Industry
Profit-expenses ratio	5.8	6.5	0.8	1.0
Profit-equity ratio	3.3	3.3	0.4	0.3
Profit-sales ratio	6.0	6.7	0.8	1.1
Asset turnover ratio	28.8	26.7	-0.5	-0.8
Financial leverage	191.9	187.3	0.6	-4.1
Material cost-output ratio	76.2	77.7	0.8	0.8
Personnel cost-output ratio	14.9	11.1	-0.9	-1.2
Ratio of personnel costs to value added	51.6	46.9	-2.4	-3.0
	CZK thousands per month		Annual percentage changes	
Book value added per employee	56.8	61.0	11.3	12.7

Chart III.37
The continuing buoyant economic growth was accompanied by rising employment
(annual percentage changes; percentage points)



III.6 THE LABOUR MARKET

In 2006 Q3, the labour market saw continuing growth in labour demand at a time of buoyant economic growth fostered mainly by foreign direct investment and

20 Assessment based on figures for non-financial corporations with 100 employees or more. These corporations account for roughly 50% of the total assets and liabilities of the non-financial corporations sector and approximately two-thirds of the value added in that sector.

related production. However, employment growth moderated further. This was partly connected with the gradual fall in economic growth during 2006 from the peak observed at the close of 2005. In line with the structural changes in the economy, employment again rose fastest in industry and market services in Q3. The seasonally adjusted unemployment rate declined again in 2006 Q3. This decline was of a cyclical nature. A faster decrease in unemployment was prevented by the professional and skills structure of the unemployed, reflected in persisting high long-term unemployment. Wage growth slackened, fostering a decrease in the growth rate of nominal unit labour costs, which indicate the evolution of the wage cost-output ratio. Overall, no across-the-board inflationary pressures were generated in the economy in 2006 Q3 by unbalanced wage and productivity growth.

III.6.1 Employment and unemployment

According to Labour Force Survey figures (from the CZSO), annual growth in the number of people employed in the economy moderated further to 0.9% in 2006 Q3. As in the previous quarter, this was due to more sluggish growth in the number of employees.[21] By contrast, a recovery in employment growth (to 4.1% year on year) was visible among entrepreneurs, but this only partly offset the impact of the slower growth in the number of employees on total employment. These changes in the employment structure are illustrated in Chart III.38. The relatively rapid increase in the number of entrepreneurs occurred mainly in market services and some branches of manufacturing[22], and especially among entrepreneurs with employees. Despite the relatively strong growth in Q3, entrepreneurs still represent a relatively small proportion of total employment (around one-fifth).

As in the previous two quarters, industry and market services were the biggest contributors to the rise in employment in 2006 Q3. The largest increase in employment was recorded in manufacturing (58,000 people, or 4.4%, year on year). This increase was linked chiefly with foreign direct investment and related activities and favourable demand. Within market services, employment in real estate, renting and numerous other business activities continued to grow rapidly (an increase of 28,200 people, or 9.5%). This growth was apparently linked with higher demand for various services at a time of continuing buoyant economic growth.[23]

Rising employment was not seen across the board even in 2006 Q3. In some branches, significant changes in demand and strong competition exerted strong downward pressures on costs through job cuts. Falling employment was recorded especially in wholesale and retail trade (-8,100 people) and financial intermediation (-7,900 people). Employee numbers also decreased in public administration, education[24], health care and veterinary activities (by a total of 17,100 people). Overall, employment growth slowed in Q3 compared to the previous quarter in both industry and services. The shares of the main sectors in total employment remained almost unchanged: 56.1% of people worked in the tertiary sector, and

CHART III.38
Total employment growth slowed in 2006 Q3
(annual percentage changes)

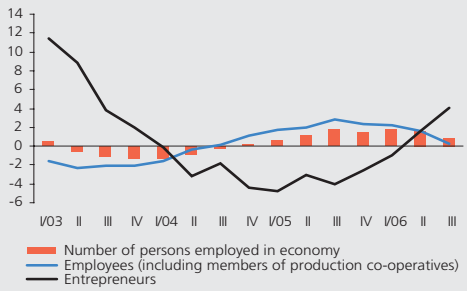
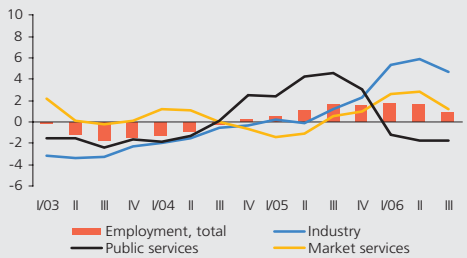


CHART III.39
Employment growth continued in industry and market services in 2006 Q3, but was lower than in Q2
(annual percentage changes)



21 Including members of production co-operatives.

22 In particular, the number of entrepreneurs rose in real estate, renting and business activities, transport, storage and communications. In manufacturing, the number of entrepreneurs increased in the manufacture of furniture.

23 Within real estate , employment rose most of all in investigation and security activities. As regards other business activities, employment picked up especially in legal and accounting activities, tax consultancy, market research, advertising and computer and related activities.

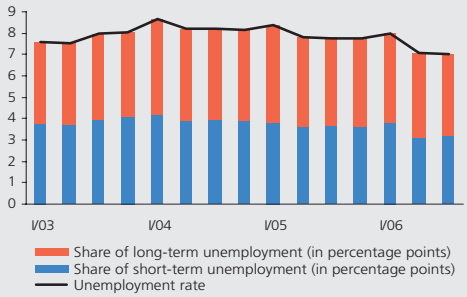
24 Employment in education declined particularly in pre-primary and primary education.

the share of the secondary sector also remained relatively high at 40%. The share of the secondary sector was the highest in the EU-25.

Chart III.40
Demand for labour has started to pass through more into registered unemployment since 2006 Q2
(seasonally adjusted numbers in thousands)

One of the indicators of labour market developments is the creation of vacancies, which should pass through – with a lag – to employment and unemployment. However, the continuing annual rise in the number of vacancies (46,000 in November) did not only reflect growth in demand for labour. Especially at the beginning of the year, the number of vacancies also grew as a result of new penalties imposed on employers who fail to report vacancies to labour offices.[25] These two effects are indicated in the Beveridge curve since the beginning of 2006, which shows that the rising labour demand did not start to help reduce unemployment significantly until Q2. In Q3, the registered unemployment rate fell by 1 percentage point year on year to 7.9%.[26] This was due partly to the exclusion of some unemployed people from the labour office register as a result of penalties.[27]

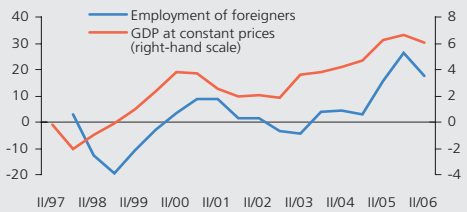
Chart III.41
The unemployment rate decreased year on year, but the share of long-term unemployment remained high
(percentages; source: LFS)



The annual decline in the number of unemployed people remained lower than the increase in employment according to the LFS in Q3, but the gap between these two indicators narrowed considerably compared to Q2.[28] This fact suggested that labour demand continued to be partly met outside the labour office register. According to the MLSA data, one of the sources of labour was foreign workers, who are employed in a number of sectors of the Czech economy. More detailed analyses have revealed that the employment of foreign workers was linked chiefly with labour demand from the skills, profession and cost perspectives rather than with the Czech Republic's accession to the EU.

The gradual improvement in the situation on the labour market for cyclical reasons did not lead to a substantial narrowing of the skills and professional gaps between the supply of, and demand for, labour in Q3. This was confirmed in particular by a persisting relatively high ratio of the long-term unemployed to total unemployment, which exceeded 50%[29], and high unemployment among people with basic education. Some changes occurred in the regional distribution of unemployment, leading to a year-on-year increase in unemployment in three regions. However, unemployment continued to fall in most regions.

Chart 1 (Box)
Employment of foreigners is influenced by GDP growth
(annual percentage changes)



BOX 1
Employment of foreign nationals

Employment of foreign workers is becoming a major phenomenon in the Czech labour market. While total employment increased by 42,100 people year on year in 2006 Q3, the number of foreigners employed in the Czech Republic (as employees or self-employed) was up by 35,900 year on year to 243,600 at the end of September. This represents roughly 5% of total employment.[30, 31]

25 The new penalties took effect in January 2006.

26 Calculation based on the available number of unemployed people. According to the CNB's calculations, the unemployment rate based on the total number of unemployed people was 8.3%. The general unemployment rate based on ILO methodology decreased by 0.8 percentage point year on year to 7.1%.

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

28 The number of unemployed people declined by 39,700 in 2006 Q3, while the number of employed people under LFS methodology rose by 42,900.

29 54% under LFS methodology.

30 LFS data on total employment and MLSA and MIT data on the number of foreigners employed. The LFS data are based on a survey of households and do not include foreigners living in hostels or commuting. The data on the share of legal employment of foreigners in total employment can therefore be regarded as an upper estimate.

31 According to Eurostat data, the share of foreigners in total employment in 2001 was 3.5% in the Czech Republic, 9.4% in Austria, 4.6% in the United Kingdom, 3.3% in Denmark and 1.0% in Hungary. The share of employment of foreigners in the Czech Republic is thus at levels common in some European countries and possibly higher than in other new EU Member States.

The extraordinary increases in the employment of foreigners in 2005 and 2006 seem to have been related to the buoyant GDP growth. Chart 1 suggests that labour demand has been an important factor affecting the employment of foreigners throughout the period since 1997. A smaller impact of administrative rules on the employment of foreigners is indicated by the fact that the employment of foreigners increased significantly during 2005, and not back in 2004 when the Czech Republic entered the EU and the conditions for the employment of EU citizens were relaxed.

Also consistent with this hypothesis is the fact that the biggest increases in the number of foreign employees are concentrated in sectors where labour demand is strong. This is particularly visible in manufacturing and real estate and renting (see Chart 2). Employment of foreigners has also been rising fast in construction and trade. These four branches employ approximately 80% of the total number of foreigners employed.

Foreign employees tend to work in manual professions, where their numbers have also been growing the fastest. They usually work as auxiliary and unskilled workers, plant and machine operators or craftsmen (see Chart 3). Almost 75% of foreign employees work in these professions. Data on registered unemployment in the Czech Republic also clearly show that 50% of the unemployed come from such professions. The growth in employment of foreigners thus reveals apparent rigidities on the labour market linked with insufficient motivation to accept job offers, to migrate to find work or to undergo retraining.

Chart 2 (Box)
The increases of foreign employees are concentrated in several sectors
(annual changes in thousands, 2006 Q1-Q3 against 2005 Q1-Q3)

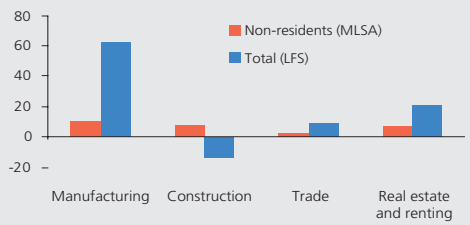
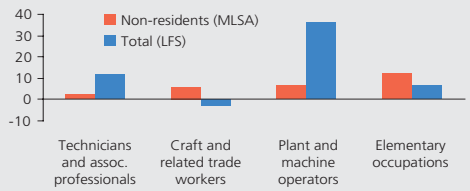


Chart 3 (Box)
In particular manual workers are being employed
(annual changes in thousands, 2006 Q1-Q3 against 2005 Q1-Q3)



III.6.2 Wages and productivity

Year-on-year growth in average nominal wages slowed further to 6.1% in 2006 Q3. In real terms, average wage growth was roughly half this figure (3.1%). Overall, however, average nominal wages grew faster in the first three quarters of 2006 than in 2005.

In 2006 Q3, average wage growth continued to be most affected by wages in the business sector, which employs more than three-quarters of employees in the monitored organisations. Moreover, the average nominal wage grew significantly faster in the business sector than in the non-business sector (see Table III.8). However, its annual growth slowed further (by 0.7 percentage points) compared to 2006 Q2, to 6.2%. This change was due mainly to slower growth in wages in industry and partly also in market services. However, according to MLSA data, annual growth in average and median hourly earnings was higher than that in the average wage (8.2% and 6.8% respectively), suggesting that the more modest growth in average wages was achieved amid a smaller annual change in the number of hours worked than in the previous quarter.

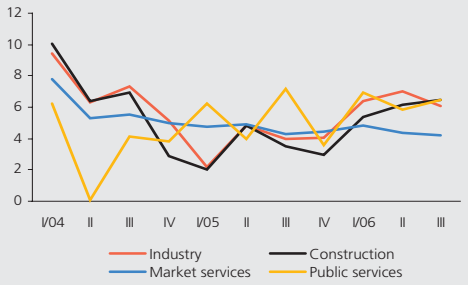
With regard to sectors, wage trends in the business sector remained very mixed and, according to the CZSO, inter-industry wage differentiation showed a year-on-year increase in 2006 Q3.[32] As mentioned in previous Inflation Reports, the differences in wage growth rates were due to a number of effects, most notably

Table III.8
Annual average wage growth decreased further in 2006 Q3
(annual percentage changes)

	2005 Q4	2006 Q1	2006 Q2	2006 Q3
Average wage in monitored organisations				
nominal	4.6	7.1	6.7	6.1
real	2.1	4.2	3.7	3.1
Average wage in business sector				
nominal	4.7	7.4	6.9	6.2
real	2.2	4.5	3.9	3.2
Average wage in non-business sector				
nominal	4.4	5.9	5.9	5.4
real	2.0	3.0	2.9	2.4
Whole-economy labour productivity	4.8	5.4	4.7	4.3
Nominal unit wage costs	-0.4	1.0	1.4	1.1

32 The coefficient of variation of average wages (by CZ-NACE category) increased by 1.9 percentage points to 35.1%.

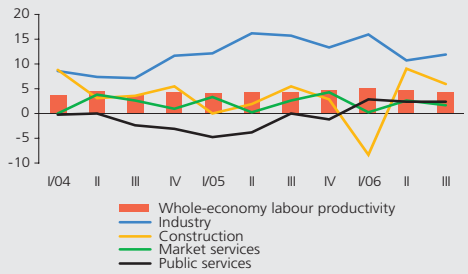
Chart III. 42
Average wage growth in industry declined in 2006 Q3, but wages rose faster in construction
(annual percentage changes)



the level of demand, the degree of competition, financial results and the other options available for reducing the wage cost-output ratio in conditions of rising prices of some production inputs (for example by employing people with low wage demands). The fastest growing average wages were recorded in construction (6.5% year on year) and non-market services (6.4%). Average wage growth in industry slowed by 1 percentage point to 6%.[33]

In the non-business sector, where wages depend mainly on legislative decisions made by the government and the capacities of the budget, the average nominal wage increased by 5.4% year on year in 2006 Q3. Slightly slower growth in wages in Q3 was recorded in all monitored groups of the non-business sector, following a stagnation at roughly 6% in the first half of the year.[34] Nonetheless, wage growth in this sector can be considered fairly even, unlike in 2005, when annual average wage growth fluctuated considerably from quarter to quarter owing to the abolition of the "thirteenth" and "fourteenth" paycheques as of 1 January 2005. It is clear from the developments to date in 2006 that this change has helped considerably to suppress differences in the wage level from one quarter to the next, making wage growth smoother.

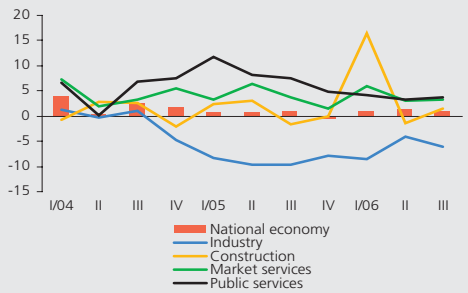
Chart III.43
Whole-economy productivity growth slowed in 2006 Q3, but remained relatively high
(annual percentage changes)



However, it is the relationship between wages and labour productivity indicators that is of key importance for inflation. The third quarter of 2006 saw a slowdown in annual whole-economy productivity growth, to 4.3%. This was primarily due to slowing growth in economic performance. Productivity growth slackened in most of the sectors monitored. The exception was industry, where productivity growth rates have been in double figures for two years now. The continuing fast productivity growth in industry was largely associated with the development of mainly export-oriented production supported by foreign direct investment. Services, where the scope for productivity gains is lower, recorded far lower annual productivity growth than industry (see Chart III.43).

However, the slower growth in whole-economy productivity in 2006 Q3 did not result in a worse wage cost-output ratio, as the slower rate of growth of average wages and, subsequently, of the total volume of wages and salaries in the economy was more pronounced. Under these circumstances, annual growth in nominal unit wage costs[35], which are an indicator of potential inflation pressures arising from wage developments, slowed by 0.3 percentage point to 1.1% in 2006 Q3.

Chart III.44
The slower wage growth fostered a slackening of nominal unit wage cost growth
(annual percentage changes)



The generally modest growth in nominal unit wage costs in the national economy was, however, very mixed in structure, as shown in Chart III.44. The biggest increase in nominal unit wage costs was recorded, as usual, by services, where the scope for offsetting rising costs by boosting productivity is limited. By contrast, a continuing annual decline in nominal unit wage costs (of 6.1%), amid considerably higher growth in productivity than in wages, was recorded in industry, where producers are exposed to the external competitive environment. It is probable that employment of foreign workers with low wage demands helped to maintain the big lead of productivity growth over average wage growth in industry. This factor also seems to have noticeably affected the wage cost-output ratio in construction, where nominal unit wage costs increased only slightly (by 1.5% year on year) in 2006 Q3 after falling in the previous quarter. It is possible that the increase in average wage growth in Q3 was partly associated with solving the problem

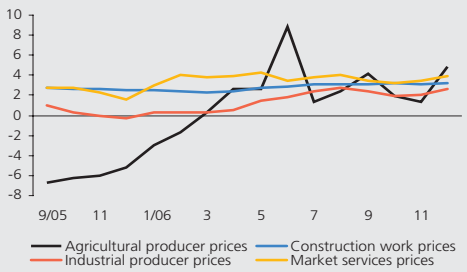
33 The data on growth in average wages in individual branches of industry are calculated from the volume of wages and the number of employees according to the national accounts.
34 Broken down by NACE category.
35 Nominal unit wage costs = volume of nominal wages and salaries / GDP at constant prices.

of shortages of skilled labour in some professions. Overall, however, wages in construction and industry did not exert upward pressures on output prices.

III.7 IMPORT PRICES AND PRODUCER PRICES

A continuing slowdown in growth of prices of energy-producing commodities on world markets in 2006 Q4 again fostered an easing of the external cost pressures on domestic inflation. The year-on-year appreciation of the koruna-dollar exchange rate acted in the same direction. As a result of these two effects, annual growth in import prices of energy-producing materials gradually moderated, turning into an annual decline in September. Thanks to this, prices in primary oil product processing either recorded an annual decline in 2006 Q4 or stagnated at the previous year's level, contributing significantly to a slowdown in overall annual industrial producer price inflation in October and November. Higher annual growth in industrial producer prices in December was mainly due to faster producer price inflation in the metal processing industry. Electricity producer prices rose quickly, too. Moderate inflation prevailed in other branches of industry, with some branches recording a halt in their upward inflation trend. Annual agricultural producer price inflation picked up pace again in December. Construction work prices stagnated at the previous quarter's level of annual growth. Annual market services price inflation stayed broadly at the level recorded in the previous quarters of 2006.

CHART III.45
Annual producer price inflation increased in industry and agriculture in 2006 Q4
(annual percentage changes)



III.7.1 Import prices

Given the high openness of the Czech economy, import prices are an important domestic inflation factor. The gradual decrease in their annual growth observed since 2006 Q2, due mainly to prices of energy-producing materials on world markets, culminated in an annual decline in import prices in October (of 1.3%). This decline deepened further in November, to 1.5%. Chart III.46 shows that this was due not only to prices of imported energy-producing materials, but in large measure also to prices of other imports[36], whose decline increased sharply in the first two months of 2006 Q4.

The slowdown in growth in world prices of energy-producing materials, observed since the end of 2006 Q2, continued into Q4. Average annual growth in prices of oil and natural gas was 37% in the first half of 2006, but declined to 23% in Q3 and just 12% in the first two months of Q4. Slowing price growth was recorded for both these energy-producing materials in this period, but was more pronounced in the case of oil.[37] This trend, combined with annual appreciation of the koruna-dollar exchange rate, fostered a year-on-year fall in import prices of mineral fuels as from September, following a lengthy period of price growth. This decline gradually deepened (to 6.4% in November).

By contrast, prices of other imported raw materials (except fuels) have on average been declining year on year since the start of 2006. In the first three quarters, the price decline in this import category reached values approaching 10%. According to the latest figures for November, prices of other imported raw materials recorded an annual decline of 4.7%. This was mainly due to falling prices of iron ore, which

CHART III.46
The decrease in import prices was mainly due to prices of energy-producing materials
(annual percentage changes; contributions in percentage points)

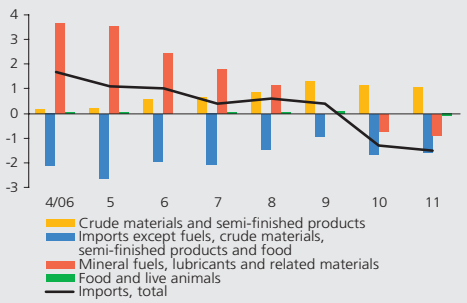
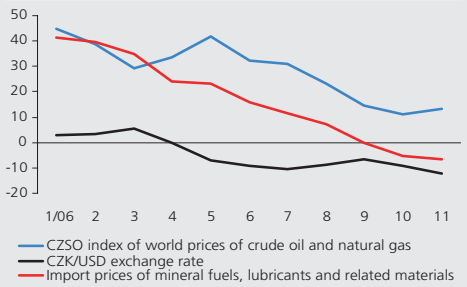


CHART III.47
Slower growth in world prices of energy-producing materials coupled with appreciation of the koruna-dollar exchange rate led to a fall in import prices of energy-producing materials
(annual percentage changes)



36 Prices of imports excluding mineral fuels, crude materials, semi-manufactures and food.

37 Annual oil price growth fell from 43.3% in January to 6.6% in November, while annual natural gas price growth declined from 46.3% to 20.5%.

is an important component of imports of other materials.[38] Prices of other metals, however, continued to rise strongly on world markets according to the CZSO world price index, although the growth slowed slightly in the first two months of 2006 Q4 (to 48.1% in November).

Prices of imported commodities with a higher degree of processing[39] have been showing an overall decline in since 2006 Q2, although their structural trends remained mixed. The most important category, machinery and transport equipment, continued to record an annual decline in prices, ranging mostly between 2% and 3% in 2006 Q3 and the first two months of Q4. Import prices of miscellaneous manufactured articles fell significantly. Compared to 2006 Q3, however, this decline moderated to 4.4% in November. The annual changes in prices of imported chemical products were mostly in very low positive or negative figures (-0.3% in November). Only in the category of manufactured goods did import prices continue to show relatively strong growth, rising gradually to 7% in September, then moderating to 5.7% in November in (see Table III.9). It is probable that import prices in this category were again largely affected by the relatively high industrial producer price inflation recorded by the Czech Republic's major trading partners, the impact of which on import prices was only partly dampened by the continuing annual appreciation of the koruna-euro and koruna-dollar exchange rates.

Table III.9
Import prices were mostly falling year on year
(annual percentage changes)

	8/06	9/06	10/06	11/06
Imports, total	0.6	0.4	-1.3	-1.5
Food and live animals	0.6	1.2	-0.2	-1.8
Beverages and tobacco	-8.6	-5.0	-4.4	-6.5
Crude materials except fuels	-7.3	-5.5	-5.6	-4.7
Mineral fuels and related products	7.4	-0.1	-5.1	-6.4
Animal and vegetable oils	2.3	4.9	4.3	5.5
Chemicals and related products	0.5	1.4	-0.4	-0.3
Manufactured goods classified by material	5.3	7.0	6.2	5.7
Machinery and transport equipment	-2.2	-1.7	-2.9	-2.8
Miscellaneous manufactured articles	-5.1	-4.3	-4.3	-4.4

Chart III.48
High import price growth continued only in the manufactured goods category
(annual percentage changes)

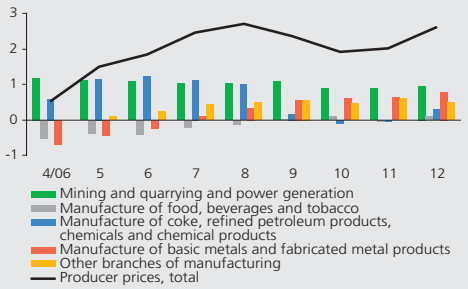
Overall, import prices were mostly falling year on year in the first two months of 2006 Q4. This was due not only to the further weakening of growth in energy-producing material prices on world markets, but also to the persisting "dampening effect" of the strong annual appreciation of the koruna-euro and koruna-dollar exchange rates. The pronounced effect of the koruna's annual appreciation was visible not only in prices of imported materials, but also in prices of imports of commodities with a high degree of processing, where it prevailed over the effect of external inflation, hence import prices of these commodities showed an annual decline. Only the surging prices of imported manufactured goods (including intermediate products) continued to increase the costs of production inputs in some industries, albeit to a lesser extent than in the previous quarter. Overall, the import price developments in the first two months of 2006 Q4 suggested an easing of the external cost pressures on domestic inflation, or a predominance of pressures in the anti-inflationary direction.

III.7.2 Producer prices

Industrial producer prices

The gradual pick-up in industrial producer price inflation visible since the start of 2006 was replaced in September by a slowdown. In December, however, producer prices in this segment accelerated again (to 2.6%; see Chart III.49). These changes were mostly due to volatile prices in the manufacture of refined petroleum products and to stronger growth in producer prices in metal processing at the end of 2006.

Chart III.49
The power generation and metal processing industries contributed most to industrial producer price inflation in 2006 Q4
(annual percentage changes; contributions in percentage points)



Producer prices in the manufacture of coke and refined petroleum products usually react to import prices of oil with a relatively short lag. Although producer prices in this industry recorded annual growth of 11.2% in August, they started declining year on year in September. In December, the previous annual fall in prices was

38 Iron ore is not included in the CZSO world price index.

39 This category consists mainly of machinery and transport equipment, manufactured goods, miscellaneous manufactured articles and chemicals and related products.

replaced by stagnation at the previous year's level (see Chart III.50)[40]. Mining and quarrying, which consists mainly of coal mining, also continued to record an annual price decline in the first two months of 2006 Q4; this turned into a slight increase in December (1.5%). High growth in prices of energy-producing commodities was thus recorded only by the electricity, gas and water supply industry, where the growth rate declined only slightly compared to Q3 (to 6.6% in December). This industry made the biggest contribution to the 2.6% increase in industrial producer prices, accounting for roughly one-third.

Prices in the food industry, whose output prices significantly affect consumer prices of food, saw less marked annual changes in Q4, fluctuating around zero (0.5% in December). This more or less non-inflationary trend was due mainly to a continuing decline in prices of some agricultural products[41] and the appreciating exchange rate of the koruna.

Industries with rising prices prevailed in the other branches of manufacturing. Nevertheless, the price growth was mostly moderate, and in some branches of manufacturing the pronounced upturn in annual inflation observed in 2006 Q3 came to a halt (see Chart III.51). Manufacture of wood and wood products and manufacture of basic metals and fabricated metal products were the only industries to record a significant pick-up in annual price growth (to 4.7% and 5.3% respectively in December); the latter accounted for almost one-third of the industrial producer inflation in December. Only the manufacture of transport equipment continued to record a longer-term annual decline in prices, reaching 1.5% in December.

Overall, industrial producer prices in 2006 Q4 showed rather mixed trends across industrial sectors. An important factor was a halt in external cost pressures on domestic inflation stemming from prices of energy-producing materials on world markets, as indicated by falling or flat producer prices at the previous year's level in primary oil product processing industries. Import prices of a number of other imported inputs also declined. On the other hand, prices of electricity, imported intermediate products and intermediate metal products of domestic origin continued to rise fast. Another important feature of industrial producer prices in Q4 was a halt in the upward inflation trend in a number of branches and the broadly subdued inflation in industry as a whole. Together, these findings confirmed weakening upward cost pressures on prices in the business sector. This trend was also supported by a continuing decline in the personnel cost-output ratio.

Chart III.50
Producer prices in primary processing of oil products were mostly falling in 2006 Q4
(annual percentage changes)

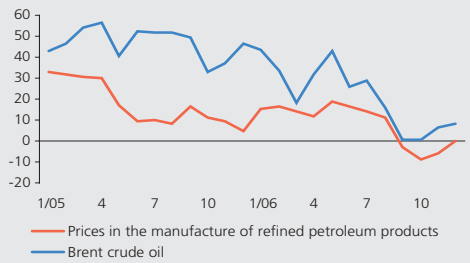
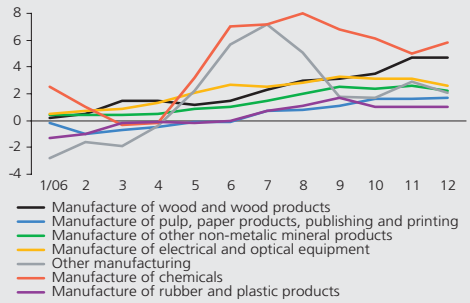


Chart III.51
The upward inflation trend halted in several major branches of industry in 2006 Q4
(annual percentage changes; selected branches)

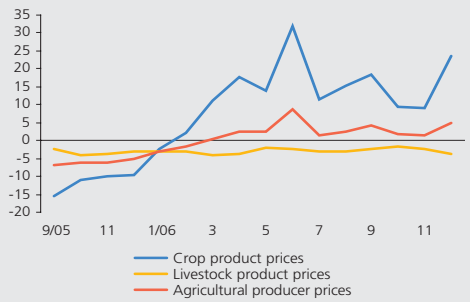


Agricultural producer prices

Agricultural producer prices remained volatile in 2006 Q4. Their annual growth was below 2% in October and November, but increased again sharply to 4.9% in December. This erratic trend was primarily due to changes in crop prices. Prices of livestock products continued to show a year-on-year decline, which increased from November onwards (see Chart III.52).

The fairly sizeable increase in annual crop price inflation in December (to 23.5%) was due to various factors. One major contributor was an extraordinary annual increase in potato prices (209.3%). Prices of cereals, the most significant commodity in the agricultural producer price index, also continued to pick up year on year in

Chart III.52
The rise in agricultural producer prices was caused by rising prices of crop products
(annual percentage changes)



40 The zero annual increase in producer prices in the manufacture of coke and refined petroleum products in December was also partly due to base effects.

41 Primarily livestock products.

Q4 (rising by 25.5% in December). This was linked with an upswing in prices after this year's average harvest. Significant annual price growth was also recorded for oil plants and vegetables (18.3% and 16.9% respectively in December). By contrast, fruit prices fell year on year in Q4.

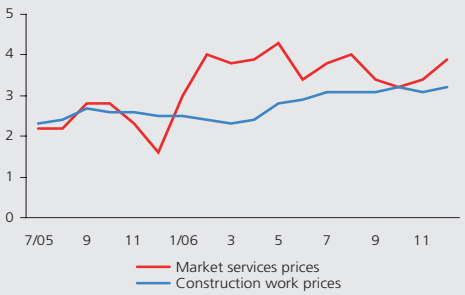
The annual decline in prices of livestock products continued into 2006 Q4, amounting to 3.9% in December. As in the previous quarter, producer prices of most major items of livestock production, particularly poultry and milk, showed a decline. The assessment of the causes of the mostly falling livestock product prices remains the same as in the previous Inflation Report. The main factor was again the exchange rate; a decline in prices of livestock production in some EU countries also played some role.

Other producer prices

Prices of construction work showed no major changes in 2006 Q4. The gradual slight pick-up in annual construction work price inflation recorded in the first half of 2006 halted in the second half of the year and inflation stabilised just above 3%. The main factor behind the gradual increase in construction work prices in the first half of 2006 and the maintaining of growth at 3% was probably higher demand. The construction work price inflation was accompanied by a pronounced upswing in prices of materials and products used in construction, which reached 3.6% in December.

Annual market services price inflation fluctuated between 3% and 4% throughout the first three quarters of 2006 and did not depart from this pattern in Q4. According to the latest figures for December, market prices rose by 3.9% year on year. As in the previous three quarters, prices of market services in Q4 were most affected by changes in prices in real estate and renting activities and other business services, which recorded a total increase of 5.9% in December.[42] Faster price growth also continued in the relatively low-weight category of other services, comprising sewerage collection charges (5%). Other categories of services maintained growth of less than 3% in the last quarter of 2006.

Chart III.53
Growth in construction work and market services prices in 2006 Q4 did not move far from the previous levels of 2006
(annual percentage changes)



42 Particularly trade fair services, architectural services and engineering services.

IV.1 EXTERNAL ASSUMPTIONS OF THE FORECAST

Expectations regarding the external environment are one of the key assumptions of the forecast. For this purpose, the CNB has as usual drawn on the publication Consensus Forecasts, which brings together the forecasts of a range of foreign analytical teams, and market outlooks. The current forecast is based on the December Consensus Forecasts data and the market information effective on the survey date. Effective developments in the euro area are used to proxy for developments in the Czech Republic's major trading partner economies. The CNB forecast uses the outlook for prices of Brent crude oil as an indicator of energy-producing material prices. In addition, the outlook for petrol prices on the ARA markets is used in forecasting fuel prices. Compared to the previous forecast, expectations regarding future external developments have shifted towards higher economic growth. On the other hand, expected prices of energy-producing products have decreased. This is reflected in a decline in expected external inflation as well. As a result of the combination of higher economic growth and lower inflation abroad, the expected foreign interest rate path has not changed significantly.

The new reference scenario assumes 1.8% growth in the effective indicator of consumer prices in the euro area last year and a rise to 2.1% this year. This rise will be due mainly to a sizeable increase in German inflation resulting from a change in the VAT rate in 2007. After this effect unwinds, growth in the effective indicator of consumer prices in the euro area will slow to 1.7% in 2008. 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. The reference scenario of the January forecast assumes that the effective indicator of producer prices in the euro area will slow from last year's 5.2% to 2.3% in both 2007 and 2008. Owing to the favourable developments in the euro area economies in the first three quarters of 2006, analysts have again significantly revised their outlook for economic growth last year and in the years ahead. Economic growth in the euro area in effective terms is thus expected to have reached 2.6% last year. As a result of the income effect of the VAT change in Germany, it should slow to 1.8% this year and pick up slightly to 1.9% in 2008.

The fall in oil prices at the end of last year exceeded expectations, as the average oil price was USD 59.60 a barrel in Q4. The new outlook for oil prices has thus shifted downwards, although the assumption of a slight price rise remains unchanged. The price of Brent crude oil is projected to rise gradually to USD 67 a barrel at the end of this year and on to USD 68 a barrel at the end of 2008. Petrol prices on the ARA market should progress similarly, rising as high as USD 680 a ton in summer 2008 with seasonal fluctuations.

Owing to the recent weakening of the dollar's exchange rate, the December Consensus Forecasts slightly revised the future dollar-euro exchange rate towards a weaker dollar, especially in the next few quarters. However, it should return to values of 1.30 USD/EUR at the one-year horizon. The dollar-euro exchange rate is expected to remain broadly at that level in 2008. The implied one-year EURIBOR trajectory is almost unchanged from the assumptions of the previous forecast, fluctuating just above 3.8% over the entire forecast horizon.

Table IV.1
Economic growth will slow down in the euro area in effective terms in 2007

	I/07	II/07	III/07	IV/07	I/08	II/08	III/08	IV/08
Brent crude oil prices (USD/barrel)	62.3	64.3	65.7	66.6	67.3	67.7	67.9	67.9
ARA petrol prices (USD/t)	561.3	613.0	623.0	579.0	616.7	680.6	665.5	620.0
GDP in euro area (effective indicator, annual, in per cent)	2.3	1.9	1.8	1.3	1.5	1.8	2.1	2.1
Producer price inflation in euro area (effective indicator, annual, in per cent)	3.0	2.1	1.7	2.2	2.3	2.3	2.3	2.2
Consumer price inflation in euro area (effective indicator, annual, in per cent)	2.7	2.2	1.8	1.6	0.9	1.5	2.1	2.3
Nominal USD/EUR exchange rate (level)	1.32	1.32	1.32	1.31	1.30	1.30	1.29	1.29
1Y EURIBOR (in per cent)	3.9	3.9	3.9	3.8	3.8	3.8	3.8	3.8

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 January forecast does not change its view regarding the public finance deficit under

ESA 95 methodology for 2006 (3.5% of GDP) and 2007 (4.0% of GDP). For 2008, the projected deficit has increased slightly to 3.9% of GDP. In connection with this rise in deficit, the estimate of the fiscal impulse, which approximates the effect of fiscal policy on economic growth, has increased somewhat for 2008. The October forecast expected fiscal policy to make a slightly negative contribution to economic growth in 2008, but the January forecast expects a modest positive contribution. Given the present political situation, however, this assumption is associated with considerable uncertainty. The estimate of the fiscal impulse in 2006 and 2007 has not changed significantly; the forecast still assumes that fiscal policy will have a pro-growth effect 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 is an assumption regarding the equilibrium values of key macroeconomic variables, especially real interest rates, the real exchange rate, real wages and the non-accelerating inflation level of output. The current position of the economy in the business cycle and the current settings of the monetary conditions are derived from these assumptions. 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, wages, 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.

Starting with the January forecast, the CNB's core prediction model has been extended to include the inflationary effect of real wage costs (see Box 2 *The extension of the core prediction model to include the effect of real wages*). No significant revision was made to the equilibrium variables in connection with this extension; only the estimate of equilibrium real wages has been newly determined. At the forecast horizon, the estimate of the rate of equilibrium real appreciation remains in the 3.5–4% range, with a gradually declining tendency. The equilibrium annual real money market interest rate still lies slightly below 1% and is also declining slowly at the forecast horizon. The assumed long-term growth rate of the non-accelerating inflation level of output is also unchanged at 5%. Following the release of the GDP growth estimate for 2006 Q3 and the revision of the data for Q1 and Q2, however, the estimate of the current growth rate of the potential, non-accelerating inflation level of output has been reduced slightly to just above 5%. The non-accelerating inflation level of output will also be growing at approximately the same pace at the forecast horizon. Equilibrium real wages are rising at a somewhat slower rate than the non-accelerating inflation level of output at the forecast horizon.

The extended model uses real marginal costs to proxy for inflation pressures from the real economy. These consist of the costs arising from the increasing volume of production (the "output gap") and wage costs (the "real wage gap"). The estimate of inflation pressures from the real economy is lower than assumed in the October forecast. Whereas the October forecast expected inflation pressures from the real economy to re-emerge during 2005, the January forecast assumes that these pressures did not emerge until 2006 H2. This change in the outlook is largely due to a revision of the GDP growth figures for 2006. The explicit incorporation of pressures arising from real wages into the new model framework also had a partial effect, as the impact of wages has been assessed as anti-inflationary since 2005 H2. The estimate of inflation pressures from the real economy in 2006 Q4 saw no major changes. The overall effect of the real economy is estimated as slightly inflationary, with the output gap having an inflationary effect and the real wage gap a slightly anti-inflationary effect.

The inflation pressures from the volume of production, approximated by the output gap, stem from the strong GDP growth of about 6% in the last two years against

a background of potential output growth of slightly below 5%. The negative output gap closed at the end of 2005 and switched to positive figures at the start of 2006. The contribution of net exports to economic growth decreased considerably in 2006, with investment and household consumption becoming the engines of growth. Government consumption was flat in 2006 and thus made no contribution to the growth in domestic demand.

The pressures from real wages are currently having an opposite, anti-inflationary, effect. The gradual rise in inflation starting in mid-2005 caused real wage growth to begin to lag behind its equilibrium value. The sharp decline in inflation in 2006 Q4 following three quarters of stability led to a reversal in the evolution of real wages, which started growing faster than would correspond to the growth in equilibrium wages. The real wage gap thus started to close, but was still negative in 2006 Q4.

Headline consumer price inflation in 2006 Q4 was lower than the October forecast. The considerable slowdown in inflation was primarily due to regulated prices and food prices. The regulated price developments had been expected by the October forecast, but the significant decrease in food price inflation had not been foreseen. Likewise, the October forecast had overestimated the contributions of indirect taxes, adjusted inflation excluding fuels and fuel prices. The deviations of actual inflation from the forecast can be explained by different-than-assumed movements in the koruna exchange rate, world oil prices and domestic cost factors.

The current settings of the real monetary conditions, which affect the future course of the business cycle, are assessed as roughly neutral overall, with both components of the monetary conditions being close to neutral. On average, the exchange rate component is assessed as roughly neutral and the interest rate component as slightly tight in 2006 Q4.

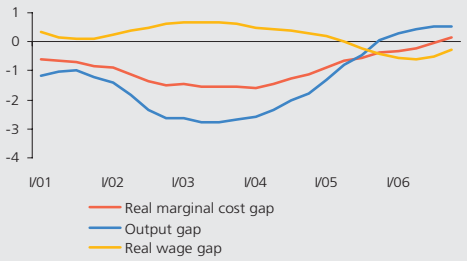
BOX 2
The extension of the core prediction model to include the effect of real wages

Starting with the current forecast, the CNB's core prediction model has been extended to include a labour market block which describes the inflationary effect of real wage costs. Although the original core prediction model implicitly included real wages, their effect was systematically taken into account only at the level of the short-term forecast, without being directly considered in the modelling of inflation pressures from the real economy by means of the core model. The output gap, which was formerly used for this purpose, is only one part of the theoretical concept of this type of inflation pressures, which reflects the effect of corporations' real marginal costs on the price of production. The extension of the model to include the effect of real wages as another potential source of inflation pressures will thus provide a more structured model-consistent insight into the inflationary effect of the real economy. At the same time, it will be possible to take into account the observed rather anti-cyclical behaviour of real wages in the Czech economy, caused by higher stickiness of nominal wages compared to prices.

The extended model distinguishes two types of inflation pressures from the real economy. The first are rising marginal costs with an increasing volume of production, which correspond to decreasing returns to production factors and are approximated by the output gap.[43] The other type of inflation

43 The estimate of the output gap in the extended model is not fully comparable with that in previous forecasts.

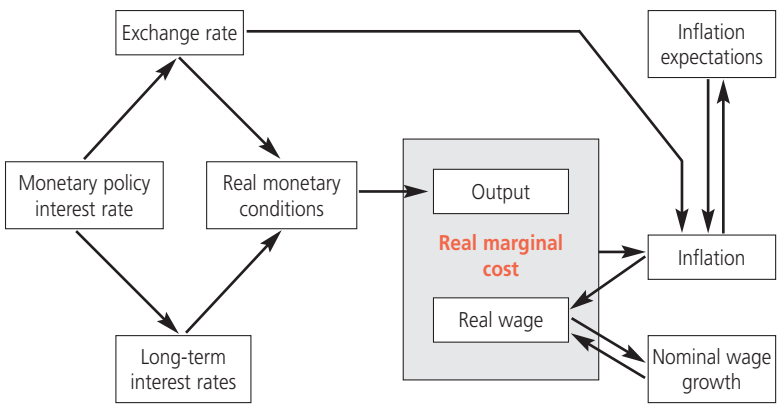
Chart 1 (Box)
Inflation pressures from the real economy were dampened by real wages
(percentages)



pressures is the effect of real wage costs. If such costs are above their equilibrium level, they have an inflationary effect, and, *vice versa*, if they are under their equilibrium level, they enable corporations not to increase the price of production. The effect of a deviation of the current level of the average real wage from its equilibrium level, which in the long run rises at the same rate as equilibrium real output (non-accelerating inflation real output), is represented by the real wage gap. The overall inflation pressures from the real economy then correspond to the aggregate effect of the output gap and the real wage gap and are described by the real marginal cost gap. The real marginal cost gap and its two components in 2001–2006 are shown in Chart 1.

Real wages in the extended model reflect nominal wages in the business sector and consumer prices adjusted for changes to indirect taxes. The forecasted nominal wage growth is determined by wage growth expectations and the real wage gap. If wages in real terms are below their equilibrium level (a negative real wage gap), households try to increase their level by means of faster nominal wage growth. As a result of the greater stickiness of nominal wages compared to prices, the real wage gap tends to move counter to the cycle in the output gap.

The scheme of the monetary policy transmission mechanism in the extended model is shown below. The central bank sets the level of nominal interest rates, which affect inflation through the direct and indirect transmission channels. The direct channel affects inflation directly through the movements of the nominal exchange rate and import prices and is identical to the original version of the model. The indirect channel, acting through the real economy, is now extended to include the real wage gap. Although the real monetary conditions continue to affect the output gap, the latter now only represents the inflation pressures arising from the volume of production. The other component of real marginal costs, the real wage gap, arises through the combination of nominal wage growth and inflation and constitutes an assessment of inflation pressures with regard to the costs of the production factor of labour.

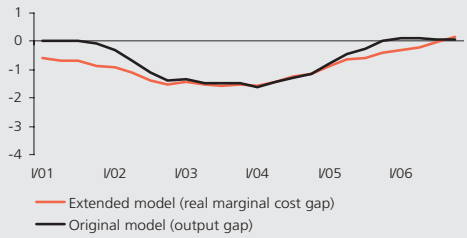


The main difference between the original approach and the new model lies in the latter's more detailed description of inflation pressures from the real economy when producing the forecast. The use of the real marginal cost gap

concept enables modelling of the potential contrary effects of the cyclical position of the economy and real wages. At the same time, this richer approach will provide a more intuitive interpretation of inflation pressures in history.

Some other equations have been modified in connection with the extension of the core prediction model described above, for example, the equation describing the formation of inflation expectations. The inflation and rates within the economic cycle and their reactions to various economic shocks in the extended model are, however, very similar to the original version. As in the original version of the model, the output gap remains in the monetary policy reaction function[44] along with the expected deviation of inflation from the inflation target. Chart 2 compares the inflation pressures identified by the original and extended models for the data used when compiling the current forecast. According to the extended model, the anti-inflationary pressures from the real economy subsided more slowly in 2005, in particular.

CHART 2 (BOX)
Inflation pressures from the real economy are assessed in a similar way in the original and extended models
(percentages)



IV.3 THE MESSAGE OF THE FORECAST

The aforementioned information on domestic and external economic developments collected since the October forecast has changed the forecast for the Czech economy. Pressures from the real economy – captured by the real marginal cost gap – will initially rise but will later gradually change from slightly inflationary to slightly anti-inflationary.

The first component of these pressures – the output gap – will gradually decrease over the forecast horizon, but will remain slightly inflationary. The narrowing of the output gap will be due to a temporary tightening of the real monetary conditions and a short-lived cooling of the external recovery. The output gap will thus remain positive mainly as a result of a positive fiscal impulse. Under these assumptions, real GDP growth will fall from 6.0% in 2006 to 5.3% in 2007 and moderate further to 4.8% in 2008.

Turning to the components of future economic growth, household consumption will play an important role. It will grow by 4% this year. This high rate of growth will be supported by rapid growth in real wages and growth in social transfers linked with legislative changes to family allowances and changes in the social benefit system. A fall in employment growth will act in the opposite direction. The interest rate component of the monetary conditions will be roughly neutral this year. Owing to a further decrease in employment growth, slowing real wage growth, an unwinding of the effects of social transfers from the previous year and a tight interest rate component of the monetary conditions, the rate of growth of real consumer spending will fall below 4% in 2008.

Growth in gross fixed capital formation will also be an important source of economic growth. Private investment will continue to be supported primarily by further growth in external demand and an inflow of actually allocated foreign direct investment. Gross fixed capital formation will thus increase by 8.7% in 2007 and almost 8% in 2008, despite slightly tighter real monetary conditions. The higher predicted growth rate compared to the previous forecast is due partly to higher-than-expected fixed investment growth in 2006.

CHART IV.1
The real economy will generate moderate inflation pressures in the short run
(percentages)

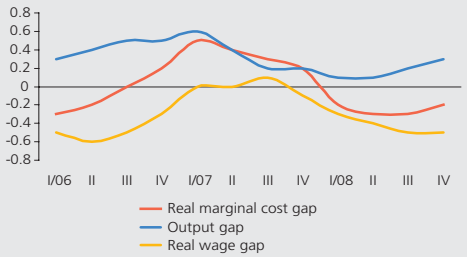
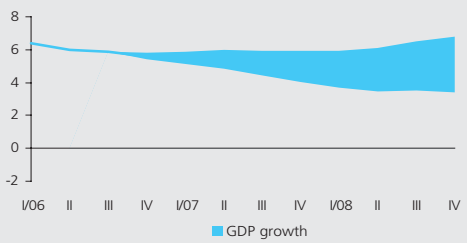


CHART IV.2
GDP growth will slow down
(annual percentage changes; seasonally adjusted)



44 The monetary policy reaction function was described in the October 2003 Inflation Report.

Table IV.2
Growth in employment will slacken
(annual percentage changes)

	2006	2007	2008
Real disposable income of households	3.9	4.0	3.7
Total employment	1.3	0.6	0.3
Unemployment rate (in per cent)[a)]	7.3	6.9	6.8
Labour productivity	4.7	4.7	4.6
Average nominal wage	6.5	6.3	6.6
Current account deficit (ratio to GDP in per cent)	-4.5	-3.9	-3.3
M2	8.8	8.5	8.8

a) ILO methodology

Table IV.3
Economic growth will gradually slow down
(annual percentage changes)

	2006	2007	2008
Gross domestic product	6.0	5.3	4.8
Household consumption	4.2	4.0	3.7
Government consumption	-0.2	1.7	0.6
Gross fixed capital formation	7.3	8.7	7.9
Imports of goods and services	13.3	10.6	10.7
Exports of goods and services	14.2	11.0	11.2
Net exports of goods and services (in CZK bn, at constant prices)	-30.7	-23.6	-10.3

Chart IV.3
The inflation forecast is in the upper half of the tolerance band of the inflation target at the monetary policy horizon
(annual percentage changes in CPI)

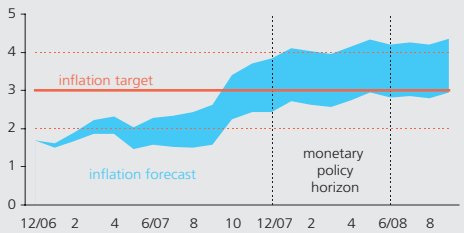
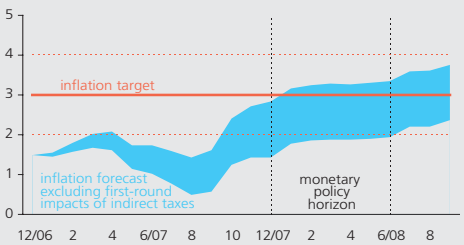


Chart IV.4
Excluding the first-round impacts of indirect taxes, the inflation forecast is in the lower half of the tolerance band of the inflation target at the monetary policy horizon
(annual percentage changes)



The forecast still assumes a growth trend in export performance, connected with FDI inflow and related changes on the supply side of the economy. A short-lived weakening of external demand growth coupled with a temporary tightening of the exchange rate component of the monetary conditions will cause the growth rate of real exports to fall to 11% this year. Real export growth should remain at the same level in 2008. Real import growth will lag only slightly behind export growth in 2007 and 2008. Relatively robust domestic demand growth and a high proportion of collaboration imports will result in year-on-year real import growth of just under 11% in both 2007 and 2008. Net exports will thus continue to contribute to GDP growth.

The second component of the real marginal cost gap – the real wage gap – will close at the beginning of the forecast period as a result of a significant lead of real wage growth over its equilibrium rate. In 2008, the real wage gap will return to negative values. This will be due to a pick-up in inflation, which amid relatively sticky nominal wage growth will lead to a fall in real wage growth. The forecast expects the average nominal wage in the business sector to grow by 6.6% in 2007 and roughly 7% in 2008.

Over the entire forecast period, the exchange rate of the koruna against the euro will be close to its current levels. The depreciation pressures stemming from the negative interest rate differential vis-à-vis other currencies and from the higher domestic inflation than in other countries will be balanced by long-term equilibrium appreciation of the real exchange rate. This long-term effect will become dominant only towards the end of the forecast horizon.

The January inflation forecast is below the October forecast over most of the forecast horizon. The revision of the outlook is due chiefly to the deviation of the inflation outturns in 2006 Q4 from the October forecast, the lower growth in indirect taxes expected for 2007 and the appreciation of the koruna at the end of last year. The forecast for the end of 2007 has decreased significantly to 3.1%. Rising regulated prices and a high contribution from changes to indirect taxes will push inflation upwards. Adjusted inflation excluding fuels and food price inflation will increase as well. At the monetary policy horizon, i.e. in 2008 H1, inflation will be in the upper half of the tolerance band of the inflation target.

In the coming years, inflation will be significantly affected by growth in regulated prices and the impacts of tax changes stemming from the need to harmonise excise duties on tobacco products with EU regulations. The average contribution of these administrative effects to annual inflation will be 1.9 percentage points at the monetary policy horizon.

The mechanism of caveats applies as usual to the first-round effects of indirect taxes, whose impact at the monetary policy horizon is pronounced. Adjusted for these effects, inflation to which monetary policy reacts is in the lower half of the tolerance band of the inflation target at the monetary policy horizon and is gradually rising towards the target.

Consistent with the macroeconomic forecast and its assumptions is broad interest rate stability initially and then a gradual rise in nominal interest rates at the forecast horizon.

No full alternative scenario was drawn up in the forecasting process. Sensitivity analyses were conducted covering the uncertainty regarding future exchange rate developments in the baseline scenario of the forecast. The results of these analyses vary depending on whether or not the exchange rate shock is expected and whether it is one-off or more permanent.

IV.4 EXPECTATIONS OF ECONOMIC AGENTS

The CNB monitors the inflation expectations of three sectors (the financial market, corporations, households) at the one-year and three-year horizons. Future inflation expected by financial market participants at the one-year horizon increased slightly, thus remaining above the CNB's target of 3%. Analysts predict that the main inflation factors will be demand-pull inflationary pressures and administrative changes in prices (excise duty on cigarettes, deregulation of rents, water supply and sewerage collection charges, and heat supply and electricity prices). The exchange rate of the koruna remains the most substantial downside factor. The inflation expectations of corporations are unchanged and remain consistent with the inflation target. Although the inflation outturns expected by households fell slightly, they are still a relatively long way above the inflation target.

At the three-year horizon, the inflation expectations of the financial market and corporations are slightly below the CNB's inflation target of 3%. The highest inflation has long been expected by the household sector; this indicator is, however, very volatile.

In Q4, interest rates expected by financial analysts increased slightly at almost all the monitored maturities. At the same time, analysts shifted their expectations towards a later start to the monetary policy tightening. The interest rate path consistent with the aforementioned CNB forecast was roughly in line with the expectations of financial market analysts over the entire horizon.

Table IV.4
Consumer prices will be significantly influenced by administrative measures
(annual percentage changes)

	I/07	II/07	III/07	IV/07	I/08	II/08	III/08
Consumer prices	1.8	1.9	2.0	3.0	3.3	3.5	3.6
Breakdown into contributions:							
regulated prices	3.6	3.4	3.4	4.5	5.2	4.5	4.2
indirect taxes a)	0.1	0.4	0.9	1.0	0.8	0.9	0.6
food prices b)	2.0	2.0	0.4	1.2	1.5	1.3	1.8
fuel prices b)	-2.9	-10.3	-12.7	-2.6	1.2	1.4	-0.5
adjusted inflation excl. fuels b)	0.9	1.2	1.2	1.5	1.9	2.3	2.9

a) contributions in percentage points
b) excluding changes to indirect taxes

Table IV.5
Inflation expectations were above the CNB's target at the one-year horizon
(percentages)

	12/05	9/06	10/06	11/06	12/06
Consumer price index					
1Y horizon:					
Financial market	2.6	3.2	3.1	3.4	3.3
Corporations	2.8	3.0			3.0
Households	4.6	5.0			4.9
3Y horizon:					
Financial market	2.5	2.7	2.7	2.7	2.7
Corporations	2.9	3.2			2.9
Households	5.2	8.1			6.5
1Y PRIBOR					
1Y horizon:					
Financial market	2.8	3.2	3.4	3.4	3.4

MINUTES OF THE BOARD MEETING ON 30 NOVEMBER 2006

Present at the meeting:
Z. Tůma (Governor), L. Niedermayer (Vice-Governor; left the meeting in order to take part in a teleconference of the General Council of the ECB; did not participate in the voting), 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 November situation report, which analysed the new information and assessed the risks of the October macroeconomic forecast.

The annual inflation of 1.3% in October had been 0.3 percentage point lower than forecasted. This deviation had been due in approximately equal measure to lower-than-expected growth in food prices and lower adjusted inflation excluding fuels. Regulated prices, fuel prices and the estimated impacts of changes to indirect taxes had all been broadly in line with the forecast. The recently passed act on excise duties on tobacco products would lead to the impact of changes to indirect taxes on inflation being roughly 0.3–0.4 percentage point higher in 2007 than predicted by the forecast. The next increase in excise duties would then be pushed back from 2007 to 2008. The current growth in industrial producer prices and agricultural producer prices was also lower than forecasted.

Newly available information on the real economy suggested no major risks to the economic activity forecast, which expects annual GDP growth to slow further to 5.4% in 2006 Q4. Despite slackening slightly, annual real retail sales growth had stayed high in Q3 in line with the forecast. Industrial and construction production had also maintained high growth rates in Q3. Growth in capital imports and a higher rate of growth of long-term loans indicated a slightly higher-than-forecasted pace of investment growth. By contrast, the current balance of payments figures implied a risk of a higher net export deficit. The unemployment rate was developing in line with the forecast, but employment growth was below expectations, especially in the services and construction sectors. Lower-than-expected wage growth in the economy was also fostering lower nominal unit labour costs and more sluggish household disposable income growth.

After the presentation of the situation report, the Board discussed the distribution of the risks in relation to the assumptions of the October forecast. The Board agreed that the risks were on the downside. In this context, however, it was also said that this might be due to a combination of several transitory anti-inflationary shocks. In such a situation the Board should not react hastily.

As part of its assessment of the fulfilment of the external assumptions of the forecast, the Board discussed the impacts of the lower oil prices and the recent appreciation of the euro against the dollar. It was said that whereas in the past these two factors had often had opposite effects on the koruna prices of oil, now both of them were having an anti-inflationary effect. Some of the board members assessed the risks of the potential negative impacts of the euro's appreciation against the dollar on the euro area economy.

In connection with the lower-than-expected growth in food prices in October, the long-term factors influencing inflation in this area were also discussed. This discussion covered the dependence of food prices in the consumer price index on agricultural producer prices, the consolidation of retail chains on the one hand and of food producers on the other, and the effect of the greater opportunities to export foods to EU markets. The opinion was expressed that food prices might be affected by the accession of two countries with very strong agricultural sectors to the EU in 2007.

The Board also discussed the exchange rate development. It was said that the current appreciation of the koruna may imply an additional downside risk for adjusted inflation excluding fuels over the next few months. Against that, opinions were expressed that the current appreciation of the exchange rate was not entirely supported by economic fundamentals. In particular, the current account deterioration, caused in part by a greater volume of dividends paid, might lead to depreciation of the koruna.

The board members also discussed the growth outlook abroad. In this context, it was said that, rather than the size of the revision of expectations concerning economic growth, it was the distribution of that change between the change in the growth rate of potential output and the output gap that was important for future inflation.

Some of the board members voiced the hypothesis that owing to the appreciation of the euro against the dollar the recent upward revision of the growth outlook may have been more a manifestation of higher growth potential.

After discussing the situation report, the Board decided unanimously to leave the two-week repo rate unchanged at 2.50%.

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MINUTES OF THE BOARD MEETING ON 20 DECEMBER 2006

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

The Board was presented with the December situation report. The presentation focused on summarising the newly available economic data and reassessing the risks of the October forecast. The downside risks to inflation associated with the October forecast had increased compared to November. The current November inflation figures were lower relative to the October forecast. Food prices had recorded the main deviation. The estimated impacts of changes to regulated prices had also moderated. The October forecast for Q3 GDP had materialised in terms of both growth and structure. The past GDP figures had meanwhile been revised downwards, which was described as a potential downside risk to inflation. Wage growth had slowed and no inflation pressures were emerging in the labour market. Current developments in the international environment were broadly neutral in relation to the risks of the October forecast. The monetary conditions had tightened somewhat.

After the presentation of the December situation report, the Board assessed the change in the distribution of the risks of the October forecast. The Board agreed that the downside risks of the forecast were even higher in December than they had been in November. At the same time, it was said that the realignment of the risks needed to be related to the October forecast. However, it was said that the forecast also contained upside risks to inflation.

It was said that the Czech economy was in a phase of economic growth which was higher than that in the euro area, and was simultaneously recording comparable or even lower inflation. The Board discussed the causes of this. The opinion was expressed that converging economies such as the Czech Republic and Poland may to some extent be resilient to inflation pressures. In this context it was stated repeatedly that increasing competition, the growing influence of the international environment, appropriate wage growth and appreciation of the exchange rate were playing a role in absorbing inflation shocks. The view was expressed that the further enlargement of the European Union might bolster some of these tendencies, for instance in the area of food prices. It was also said that pressure for lower consumer price inflation was apparent throughout Europe and hence was not typical of Central Europe alone.

The Board further considered the risks of the October forecast. The Board stated that the stronger-than-forecasted exchange rate was a considerable downside risk to inflation. Another downside risk was the lower-than-expected inflation in past months. The discussion of the upside risks focused on the ongoing strong economic growth, which now involved virtually all components of GDP. The opinion was expressed that the corresponding good corporate results might be an inflationary factor, as they might lead to higher investment demand and, secondarily, to higher consumer demand as well. In this context, however, it was said that the good corporate results might also have an anti-inflationary effect, because they might provide an incentive for foreign investors to invest more in the Czech Republic, which would generate appreciation pressures and simultaneously increase labour capitalisation, thereby boosting labour productivity. It was said that the money supply and consumer credit were growing relatively fast and that this might generate demand pressures. However, the Board was not united in its evaluation of the money growth as a potential upside risk to inflation. In response it was said that the correlation between money growth and inflation was fairly weak in the Czech Republic. It was said that rent deregulation might act as an inflationary impulse, as suggested by the experience in the mid-1990s. Another inflationary impulse mentioned was the expected rise in electricity prices in 2007.

The Board also discussed some factors affecting the exchange rate. It was said that information on the balance of payments is important for forming an opinion on future economic developments. For example, changes in the structure of foreign investment and other capital flows can signal a change in the significance of the interest rate differential. It was also said that a lengthening hedging transaction horizon can affect the exchange rate. Comment was made on the effective exchange rate of the koruna, which had been more stable than the exchange rate of the koruna against the euro. It was said that the greater stability had been due to faster appreciation of the currencies of some of the Czech Republic's trading partners, which might affect the relative competitiveness of the Czech economy.

At the close of the meeting, the Board decided unanimously to leave the two-week repo rate unchanged at 2.50%.

MINUTES OF THE BANK BOARD MEETING ON 25 JANUARY 2007

Present at the meeting:
Z. Tůma (Governor), L. Niedermayer (Vice-Governor), M. Singer (Vice-Governor), M. Hampl (Chief Executive Director), R. Holman (Chief Executive Director), V. Tomšík (Chief Executive Director).

The Board discussed the January situation report containing the new forecast for inflation and other macroeconomic indicators. According the new forecast a modest slowdown in economic growth and persisting low monetary policy inflation (i.e. consumer price inflation adjusted for the first-round effects of indirect taxes) could be expected. The forecast for monetary policy inflation was gradually approaching 3% from below at the monetary policy horizon. By contrast, headline consumer price inflation should be above the 3% level at this time, as changes to indirect taxes were expected to have a significant effect. Compared to the previous macroeconomic forecast from October last year, expected inflation and forecast-consistent interest rates had been revised downwards. This was a result of the lower-than-expected inflation in 2006 Q4, the appreciation of the koruna exchange rate at the year-end and a smaller expected increase in indirect taxes in 2007. Economic growth was forecasted at approximately 5.3% in 2007 and 4.8% in 2008

An extended core model – newly containing an equation modelling the labour market – had been used in the preparation of the forecast. The overall inflation pressures from the real economy were thus now described in a more structured way by means of the real marginal cost gap, consisting of the real wage gap and a redefined output gap. The overall effect of the real economy was currently estimated as slightly inflationary, with the output gap having an inflationary effect and the real wage gap a slightly anti-inflationary effect. Compared to the October forecast, the estimate of future inflation pressures from the real economy was consequently lower. Expected external economic growth had risen, but on the other hand energy prices had fallen and lower external inflation could be expected as a result.

Consistent with the new macroeconomic forecast and its assumptions was a period of interest rate stability and then a gradual rise in interest rates.

After the presentation of the situation report, the Board discussed the risks and uncertainties associated with the new forecast. The Board agreed that there were risks on both the upside and downside. The future evolution of the exchange rate was viewed as a two-sided risk. At the time of the meeting, the koruna's rate against the euro was weaker than assumed in the forecast, and this posed an upside risk to inflation. At the same time there was a consensus that a further correction of the earlier rapid appreciation could not be ruled out either. This might occur as a result of the negative interest rate differential, which could, moreover, widen further. That said, according to market expectations the koruna should be stronger in the future than according to the CNB forecast, and this posed a downside risk to inflation. It was stated in the discussion that this was consistent with the persisting attractiveness of the Czech economy and the still sufficient room for foreign direct investment inflow. The argument was also made that the appreciation of the Czech currency against the euro was linked with developments in the region and that the decision-making of large financial investors was not based solely on the interest rate differential.

There was a consensus that the upside risks to inflation also included the robust economic growth in neighbouring countries, as the latest indicators from these countries were even better than originally assumed in the forecast. Conversely, the opinion was expressed that oil prices were a medium-term downside risk owing to the observed fall in aggregate demand for this commodity, the opening of new oil fields and the shrinking role of oil as an alternative investment asset. Against this, however, it was said that a deviation in prices of oil and oil products would have to be big to be economically significant. The discussion of the risks then turned to the determinants of food prices going forward. Strong and persisting competition on the Czech food market, the opening of the European market and continuing cost optimisation in primary agricultural production were given as reasons why food represents a downside risk for the forecast. Against this, however, the argument was made that the gradual transition of foods from non-tradable to tradable commodities might have the opposite effect, because the price level on the Czech market was lower than in other relevant countries.

The Board also focused on fiscal policy developments. Here it saw risks on both sides in relation to the forecast. If the new government succeeded in its plans to cut the budget deficit, this might foster lower-than-forecasted

inflation. Conversely, the proposed tax changes, in particular the potential raising of the lower VAT rate, might have inflationary effects.

The discussion also covered the trends and equilibrium variables on which the forecast was based. The opinion was expressed that large industrial investments – for example the new car plant in Kolín – imply a transitory increase in growth in the potential, non-accelerating inflation level of output. That in turn poses a downside risk to inflation. By contrast, regarding the trends on the labour market the opinion was expressed that wage growth may represent a medium-term upside risk, as the fairly subdued wage growth to date was extrapolated in the forecast. It was said that although wages in the lowest-paid jobs might have been depressed by the inflow of cheap labour, this factor may now be reaching its limits. Mention was also made of the more general question of whether the current faster growth in profits than wages was sustainable and whether the opposite phenomenon might be seen in the future.

There was also a more general discussion of the rapid rise in asset prices amid low consumer price inflation. The board members discussed whether or not monetary policy should respond to asset price movements. The opinion was expressed that it should not, as the asset price growth may be just a consequence of rapidly rising wealth coupled with limited investment opportunities. From this point of view it was possible to view the asset price movements as equilibrium ones. It was also said that if monetary policy did respond to the rising asset prices, consumer prices would probably fall. There was also a related discussion of the negative effect of the deflation which was maybe occurring as a result of the statistical overvaluation of inflation. However, it was also said in this discussion that prices of tradable commodities had been falling for some time without this causing any major problems to the relevant sector.

In light of the numerous risks, the Board agreed that there was greater uncertainty regarding future interest rates consistent with the fulfilment of the inflation target. Opinions were also expressed that a future rate cut could not be ruled out, depending on how the situation develops.

After discussing the situation report, the Board decided unanimously to leave the two-week repo rate unchanged at 2.50%.

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	2.9	3.1	2.7	1.3	1.5	1.7
Regulated prices	11.0	11.0	11.2	11.5	12.4	10.5	9.7	9.8	9.8	4.9	4.8	4.9
(contribution to consumer price inflation)	*2.27*	*2.28*	*2.30*	*2.37*	*2.55*	*2.19*	*2.02*	*2.06*	*2.05*	*1.08*	*1.07*	*1.08*
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*	*0.39*	*0.21*	*0.21*	*0.21*	*0.21*	*0.16*
Net inflation	0.5	0.3	0.1	0.1	0.3	0.3	0.7	1.1	0.5	0.1	0.2	0.7
(contribution to consumer price inflation)	*0.40*	*0.23*	*0.08*	*0.09*	*0.22*	*0.24*	*0.55*	*0.88*	*0.43*	*0.06*	*0.17*	*0.54*
of which: prices of food, beverages and tobacco	-1.0	-1.6	-1.8	-1.5	-1.3	-0.6	0.5	1.3	1.4	0.4	0.4	0.9
(contribution to consumer price inflation)	*-0.25*	*-0.41*	*-0.47*	*-0.39*	*-0.34*	*-0.15*	*0.13*	*0.34*	*0.35*	*0.12*	*0.12*	*0.25*
adjusted inflation	1.2	1.2	1.0	0.9	1.1	0.7	0.8	1.0	0.1	-0.1	0.1	0.5
(contribution to consumer price inflation)	*0.65*	*0.64*	*0.55*	*0.48*	*0.56*	*0.39*	*0.42*	*0.54*	*0.08*	*-0.06*	*0.05*	*0.29*
Inflation rate (annual moving average)	2.0	2.1	2.2	2.3	2.4	2.5	2.6	2.7	2.8	2.7	2.6	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	0.4	0.2	-0.7	-0.5	-0.1	0.2
Regulated prices	4.1	0.2	0.2	0.1	0.9	0.1	0.0	0.2	0.0	-0.9	0.0	0.0
(contribution to consumer price inflation)	*0.89*	*0.04*	*0.03*	*0.02*	*0.21*	*0.02*	*0.00*	*0.04*	*-0.01*	*-0.21*	*-0.01*	*0.01*
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*	*0.00*	*-0.18*	*0.00*	*0.00*	*0.00*	*0.00*
Net inflation	0.4	-0.1	-0.3	0.2	0.4	0.3	0.6	0.4	-0.9	-0.4	-0.1	0.2
(contribution to consumer price inflation)	*0.33*	*-0.05*	*-0.21*	*0.12*	*0.28*	*0.20*	*0.47*	*0.31*	*-0.69*	*-0.31*	*-0.09*	*0.16*
of which: prices of food, beverages and tobacco	0.2	-0.6	-0.3	0.1	0.7	0.9	-0.2	0.2	-0.1	-0.5	0.1	0.6
(contribution to consumer price inflation)	*0.04*	*-0.15*	*-0.08*	*0.02*	*0.17*	*0.23*	*-0.05*	*0.05*	*-0.03*	*-0.13*	*0.03*	*0.15*
adjusted inflation	0.5	0.2	-0.2	0.2	0.2	-0.1	1.0	0.5	-1.2	-0.4	-0.2	0.0
(contribution to consumer price inflation)	*0.29*	*0.10*	*-0.12*	*0.10*	*0.12*	*-0.03*	*0.53*	*0.26*	*-0.65*	*-0.19*	*-0.12*	*0.01*

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	18.8	19.0	18.2	17.6	17.5	17.7	17.9
Food and non-alcoholic beverages	197.6	6.4	6.2	6.0	6.2	7.0	8.5	8.1	7.3	7.1	6.3	6.4	7.6	6.9
Alcoholic beverages and tobacco	79.2	13.5	13.7	13.7	13.5	14.0	13.7	13.9	13.9	13.9	14.0	14.2	13.4	13.8
Clothing and footwear	56.9	-22.1	-23.0	-23.2	-23.1	-23.2	-23.6	-25.3	-25.6	-25.3	-24.7	-24.3	-23.9	-23.9
Housing, water, electricity, gas and other fuels	236.4	44.1	44.4	44.5	44.8	44.9	45.0	45.1	45.1	45.2	44.3	44.3	44.3	44.7
Furnishings, household equipment and routine maintenance of the house	67.9	-6.8	-6.8	-7.0	-7.0	-7.1	-7.3	-7.4	-7.4	-7.4	-7.4	-7.3	-7.3	-7.2
Health	14.3	30.9	31.3	32.3	32.8	34.1	34.9	35.0	37.9	38.3	37.5	36.8	36.7	34.9
Transport	101.4	8.5	8.7	8.5	10.1	11.4	11.3	12.2	12.4	11.3	9.3	8.3	8.0	10.0
Communications	22.5	38.8	36.0	36.0	33.1	40.5	40.5	41.5	42.2	42.1	42.2	42.1	42.1	39.8
Recreation and culture	95.5	12.0	13.3	12.1	11.4	11.7	11.6	17.4	20.3	12.4	11.5	10.7	10.9	12.9
Education	4.5	20.1	20.2	20.1	20.1	20.1	20.1	20.1	20.1	23.2	23.2	23.2	23.2	21.1
Hotels, cafés and restaurants	74.2	23.6	24.0	24.1	24.4	24.6	24.8	25.0	25.2	25.5	25.6	25.8	26.0	24.9
Miscellaneous goods and services	49.5	21.9	22.5	22.7	22.9	23.0	22.9	23.3	23.3	23.3	23.4	23.4	23.4	23.0

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 12	2006 3	2006 6	2006 9	2006 12
1. Food and non-alcoholic beverages	197.6	2.1	5.7	6.6	5.6	6.0	8.5	7.1	7.6
- tradables	197.6	2.1	5.7	6.6	5.6	6.0	8.5	7.1	7.6
2. Alcoholic beverages and tobacco	79.2	7.1	7.8	11.6	12.4	13.7	13.7	13.9	13.4
- tradables	79.2	7.1	7.8	11.6	12.4	13.7	13.7	13.9	13.4
3. Clothing and footwear	56.9	-7.7	-11.9	-14.6	-20.2	-23.2	-23.6	-25.3	-23.9
- nontradables	1.4	18.3	21.1	35.9	38.4	40.8	41.8	42.5	43.0
- tradables	55.5	-8.4	-12.7	-15.9	-21.7	-24.8	-25.3	-27.0	-25.6
4. Housing, water, electricity, gas and other fuels	236.4	24.3	26.6	32.2	38.9	44.5	45.0	45.2	44.3
- nontradables	226.1	25.2	27.5	33.2	40.1	45.9	46.5	46.5	45.6
- tradables	10.3	4.0	5.9	10.7	12.4	12.6	11.6	15.5	16.7
5. Furnishings, household equipment and routine maintenance of the house	67.9	-1.0	-3.0	-4.9	-6.6	-7.0	-7.3	-7.4	-7.3
- nontradables	2.9	9.9	12.3	16.8	17.3	19.0	20.0	20.3	20.4
- tradables	65.0	-1.5	-3.7	-5.9	-7.7	-8.2	-8.5	-8.6	-8.5
6. Health	14.3	12.8	16.4	20.6	29.5	32.3	34.9	38.3	36.7
- nontradables	11.0	15.4	19.9	25.2	36.5	40.0	43.3	47.7	45.7
- tradables	3.3	4.4	5.1	5.6	6.7	7.1	7.4	7.5	7.3
7. Transport	101.4	4.1	3.6	5.0	8.8	8.5	11.3	11.3	8.0
- nontradables	27.4	16.0	18.4	23.0	26.8	28.6	28.9	30.4	31.2
- tradables	74.0	-0.3	-1.9	-1.6	2.1	1.1	4.8	4.3	-0.6
8. Communications	22.5	8.2	7.2	21.0	38.1	36.0	40.5	42.1	42.1
- nontradables	21.0	2.1	12.1	32.8	46.5	46.5	53.9	53.7	53.7
- tradables	1.5	95.9	-62.3	-92.6	-82.3	-85.8	-94.2	-79.4	-75.2
9. Recreation and culture	95.5	7.2	6.1	7.9	10.5	12.1	11.6	12.4	10.9
- nontradables	60.4	16.2	16.7	21.2	27.4	30.0	30.0	32.0	29.5
- tradables	35.1	-8.3	-12.1	-15.0	-18.6	-18.7	-20.0	-21.3	-21.1
10. Education	4.5	11.3	12.0	18.1	20.2	20.1	20.1	23.2	23.2
- nontradables	4.5	11.3	12.0	18.1	20.2	20.1	20.1	23.2	23.2
11. Hotels, cafés and restaurants	74.2	8.7	10.8	19.6	22.8	24.1	24.8	25.5	26.0
- nontradables	74.2	8.7	10.8	19.6	22.8	24.1	24.8	25.5	26.0
12. Miscellaneous goods and services	49.5	11.9	15.2	20.3	20.9	22.7	22.9	23.3	23.4
- nontradables	22.0	25.8	36.4	48.4	51.5	55.4	56.0	56.4	56.6
- tradables	27.5	0.8	-1.7	-2.2	-3.5	-3.4	-3.5	-3.1	-3.1
Household consumer prices, total	1,000.0	9.0	10.1	13.2	15.7	17.3	18.3	18.2	17.7
Tradables	549.1	0.6	0.3	0.3	-0.3	-0.6	0.5	-0.1	-0.5
- food	276.8	3.5	6.3	8.0	7.5	8.2	10.0	9.0	9.3
- others	272.3	-2.4	-5.8	-7.6	-8.3	-9.5	-9.1	-9.5	-10.4
Nontradables	450.9	19.2	22.0	29.0	35.2	39.1	39.9	40.6	39.8
- others	271.2	16.5	19.4	29.9	32.8	35.1	35.5	36.4	36.1
- regulated	179.7	23.2	26.0	27.7	38.8	45.0	46.7	46.9	45.5

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
7/06	2.9	—	—
8/06	3.1	—	—
9/06	3.2	3.0	5.0
10/06	3.1	—	—
11/06	3.4	—	—
12/06	3.3	3.0	4.9

Source: CNB statistical survey

Table 5

HARMONISED INDEX OF CONSUMER PRICES annual percentage changes

	2002 12	2003 12	2004 12	2005 12	2006 12
European Union (25 countries)	2.1	1.9	2.4	2.1	2.1
European Union (15 countries)	2.2	1.8	2.2	2.2	2.1
Belgium	1.3	1.7	1.9	2.8	2.1
Czech Republic	0.1	0.9	2.5	1.9	1.5
Denmark	2.6	1.2	0.9	2.2	1.7
Germany	1.2	1.0	2.3	2.1	1.4
Estonia	2.7	1.2	4.8	3.6	5.1
Greece	3.5	3.1	3.1	3.5	3.2
Spain	4.0	2.7	3.3	3.7	2.7
France	2.2	2.4	2.3	1.8	1.7
Ireland	4.6	3.0	2.4	1.9	
Italy	2.9	2.5	2.4	2.1	2.1
Cyprus	3.1	2.2	3.9	1.4	1.5
Latvia	1.5	3.5	7.4	7.1	6.8
Lithuania	-0.9	-1.3	2.8	3.0	4.5
Luxembourg	2.8	2.4	3.5	3.4	2.3
Hungary	4.9	5.6	5.5	3.3	6.6
Malta	2.1	2.4	1.9	3.4	0.8
Netherlands	3.2	1.6	1.2	2.0	1.7
Austria	1.7	1.3	2.5	1.6	1.6
Poland	0.8	1.6	4.4	0.8	1.4
Portugal	4.0	2.3	2.6	2.5	2.5
Slovenia	7.1	4.7	3.3	2.4	3.0
Slovakia	3.2	9.4	5.8	3.9	3.7
Finland	1.7	1.2	0.1	1.1	1.2
Sweden	1.6	1.8	0.9	1.3	1.4
United Kingdom	1.7	1.3	1.7	1.9	3.0

Source: Eurostat

Table 6

MONETARY SURVEY					position at month-end in CZK billions
	2002	2003	2004	2005	2006
	12	12	12	12	11
Total assets	1,651.8	1,766.1	1,844.1	1,992.1	2,141.9
Net external assets (NEAs)	926.1	821.5	863.3	1,076.4	977.7
NEAs of CNB	715.6	687.5	634.1	724.7	671.0
NEAs of OMFIs	210.5	134.0	229.3	351.7	306.7
Net domestic assets	725.8	944.5	980.8	915.8	1,164.2
Domestic loans	940.0	1,145.6	1,147.0	1,166.6	1,399.7
Net credit to government (NCG) (including securities)	215.8	354.0	257.5	99.1	118.1
NCG to central government (including securities)	260.4	408.7	312.4	163.0	206.9
NCG to other government (including securities)	-44.6	-54.8	-54.9	-64.0	-88.8
Loans to corporations and households					
(excluding securities)	724.2	791.6	889.4	1,067.5	1,281.6
Loans to corporations (excluding securities)	542.7	554.1	574.2	649.7	756.7
Loans to households (excluding securities)	181.5	237.5	315.2	417.8	524.9
Other net items (including securities and capital)	-214.3	-201.1	-166.2	-250.8	-235.5
Holdings of securities	18.5	16.6	18.8	14.4	12.1
Issued securities	-48.6	-51.6	-74.9	-119.1	-124.8
Liabilities					
Monetary aggregate M2	1,651.8	1,766.1	1,844.1	1,992.1	2,141.9
Monetary aggregate M1	787.7	902.8	962.3	1,087.3	1,241.6
Currency in circulation	197.8	221.4	236.8	263.8	292.0
Overnight deposits	589.9	681.4	725.6	823.5	949.6
Overnight deposits - households	315.6	372.1	410.8	456.6	532.8
Overnight deposits - corporations	274.3	309.3	314.7	367.0	416.8
M2-M1 (quasi money)	864.1	863.3	881.8	904.8	900.3
Deposits with agreed maturity	651.2	666.4	675.3	671.4	641.4
Deposits with agreed maturity - households	448.6	439.8	458.6	445.1	429.7
Deposits with agreed maturity - corporations	202.5	226.6	216.7	226.3	211.7
Deposits redeemable at notice	194.3	185.6	198.8	224.1	247.8
Deposits redeemable at notice - households	190.7	182.3	194.6	220.6	243.5
Deposits redeemable at notice - corporations	3.6	3.2	4.2	3.6	4.3
Repurchase agreements	18.6	11.3	7.6	9.3	11.1
Annual percentage changes					
M1	35.0	14.6	6.6	13.0	15.2
M2	3.5	6.9	4.4	8.0	9.0
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	1.5
Annual percentage growth rates					
M1	__	15.5	8.3	13.1	15.7
M2	__	8.1	5.8	8.1	9.6
Loans to corporations and households	__	11.8	15.3	20.8	22.2
M2-M1 (deposits)	__	1.2	3.3	2.6	2.1

Table 7

INTEREST RATES ON INTERBANK DEPOSITS

percentages

	2002 12	2003 12	2004 12	2005 12	2006 12
1. Average PRIBOR [1]					
- 1 day	2.75	1.98	2.49	2.00	2.48
- 7 day	2.76	2.02	2.51	2.04	2.51
- 14 day	2.76	2.03	2.51	2.04	2.51
- 1 month	2.73	2.04	2.53	2.05	2.52
- 2 month	2.67	2.06	2.55	2.10	2.54
- 3 month	2.63	2.08	2.57	2.17	2.56
- 6 month	2.60	2.13	2.67	2.33	2.67
- 9 month	2.60	2.22	2.76	2.44	2.79
- 12 month	2.60	2.30	2.85	2.53	2.89
2. Average PRIBID [1]					
- 1 day	2.65	1.88	2.39	1.90	2.38
- 7 day	2.67	1.92	2.41	1.94	2.41
- 14 day	2.67	1.93	2.41	1.94	2.41
- 1 month	2.64	1.94	2.43	1.95	2.42
- 2 month	2.57	1.96	2.45	2.00	2.44
- 3 month	2.54	1.98	2.47	2.07	2.46
- 6 month	2.51	2.03	2.57	2.23	2.57
- 9 month	2.51	2.12	2.66	2.34	2.69
- 12 month	2.51	2.20	2.75	2.43	2.79

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	12
3 * 6	2.52	2.23	2.74	2.46	2.71
3 * 9	2.54	2.36	2.81	2.57	2.83
6 * 9	2.52	2.47	2.85	2.66	2.92
6 * 12	2.58	2.64	2.92	2.74	3.02
9 * 12	2.61	2.77	2.97	2.79	3.08
9*12 - 3*6 spread	0.10	0.55	0.24	0.33	0.37
6*12 - 3*9 spread	0.04	0.28	0.12	0.17	0.19

IRS RATES					percentages; monthly averages
	2002	2003	2004	2005	2006
	12	12	12	12	12
1Y	2.63	2.41	2.82	2.56	2.86
2Y	2.85	2.98	3.06	2.82	3.09
3Y	3.18	3.38	3.27	3.00	3.21
4Y	3.46	3.69	3.45	3.13	3.31
5Y	3.70	3.93	3.62	3.25	3.40
6Y	3.91	4.13	3.77	3.33	3.46
7Y	4.08	4.29	3.89	3.40	3.52
8Y	4.23	4.43	4.00	3.46	3.58
9Y	4.36	4.54	4.09	3.52	3.63
10Y	4.47	4.64	4.17	3.58	3.68
15Y	4.77	4.97	4.40	3.78	3.83
20Y	—	5.11	4.54	3.88	3.89
5Y - 1Y spread	1.07	1.52	0.80	0.69	0.54
10Y - 1Y spread	1.84	2.23	1.35	1.02	0.82

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	5.5	1.7	-0.8	-0.2	2.6	-1.0	0.2	0.7	3.6
7/06	2.0	2.8	5.7	1.7	-0.9	-0.1	2.7	-1.2	-0.1	0.7	3.5
8/06	2.3	2.7	5.8	1.9	-0.8	-0.3	2.7	-1.2	-0.4	0.0	3.1
9/06	2.2	2.9	5.8	1.9	-0.4	0.2	3.0	-0.8	-0.2	0.5	3.3
10/06	2.5	3.1	6.1	2.0	1.2	1.8	4.7	0.7	0.6	1.2	4.1
11/06	2.5	3.0	6.0	2.0	1.0	1.5	4.4	0.5	0.5	1.0	3.9
12/06	2.5	2.9	—	—	0.8	1.2	—	—	-0.1	0.3	—

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	-0.8	-0.2	2.6	-1.0	-0.8	-0.3	2.5	-1.1	-3.7	-3.2	-0.4	-3.9
7/06	-0.9	-0.1	2.7	-1.2	—	—	—	—	—	—	—	—
8/06	-0.8	-0.3	2.7	-1.2	—	—	—	—	—	—	—	—
9/06	-0.9	-0.3	2.5	-1.3	-0.8	-0.1	2.7	-1.1	-2.7	-2.0	0.7	-3.0
10/06	-0.6	0.0	2.9	-1.1	—	—	—	—	—	—	—	—
11/06	-0.9	-0.4	2.5	-1.3	—	—	—	—	—	—	—	—
12/06	-0.8	-0.4	—	—	-0.5	-0.1	—	—	-2.3	-1.9	—	—

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 11
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	6.79
- maturity up to 1 year	10.35	11.21	12.82	12.96	13.76
- maturity over 1 year and up to 5 years	10.80	10.17	12.40	11.43	11.33
- maturity over 5 years	7.35	6.65	6.39	5.96	5.84
for consumption - total	13.83	13.83	14.89	13.88	13.59
- maturity up to 1 year	13.05	14.26	15.48	16.22	17.29
- maturity over 1 year and up to 5 years	14.48	13.86	15.17	14.94	14.71
- maturity over 5 years	12.55	13.21	13.45	11.85	11.93
for house purchase - total	7.11	6.31	5.93	5.24	4.93
- maturity up to 1 year	7.67	6.24	4.48	4.29	5.46
- maturity over 1 year and up to 5 years	7.90	7.05	6.57	6.22	6.17
- maturity over 5 years	6.88	6.09	5.89	5.19	4.89
other - total	6.99	7.80	7.50	7.09	6.88
- maturity up to 1 year	6.64	8.49	8.96	9.09	9.57
- maturity over 1 year and up to 5 years	6.34	8.02	7.63	7.17	7.72
- maturity over 5 years	7.61	7.02	6.58	5.79	5.53
Non-financial corporations (S.11) - total	5.19	4.53	4.75	4.20	4.49
- maturity up to 1 year	4.34	4.08	4.35	3.84	4.31
- maturity over 1 year and up to 5 years	5.47	4.64	4.68	4.18	4.39
- maturity over 5 years	6.34	5.14	5.39	4.72	4.77
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	1.26
overnight	0.94	0.50	0.52	0.40	0.40
with agreed maturity - total	2.26	2.02	2.13	1.92	1.98
- with agreed maturity up to 2 years	1.68	0.96	1.37	1.03	1.47
- with agreed maturity over 2 years	3.04	2.90	2.69	2.50	2.35
redeemable at notice - total	1.81	1.26	1.63	1.71	1.93
- redeemable at notice up to 3 months	1.93	1.67	2.14	2.27	2.32
- redeemable at notice over 3 months	1.73	0.98	1.12	0.81	1.00
Non-financial corporations (S.11) - total	1.25	0.85	1.21	0.91	1.19
overnight	0.94	0.64	0.68	0.52	0.79
with agreed maturity - total	2.16	1.50	2.08	1.64	2.02
- with agreed maturity up to 2 years	2.15	1.49	2.05	1.61	2.02
- with agreed maturity over 2 years	3.47	3.04	3.12	2.47	2.39
redeemable at notice - total	1.64	1.17	1.60	1.14	1.59
- redeemable at notice up to 3 months	1.60	1.14	1.49	1.07	1.50
- redeemable at notice over 3 months	2.26	1.32	2.26	1.64	2.09

Table 12

BALANCE OF PAYMENTS [1]					in CZK millions
	2002	2003	2004	2005 [2]	2006 [2]
	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q3
A. Current account	-136,378.1	-160,614.6	-167,348.2	-61,670.2	-48,442.7
Balance of trade [3]	-71,323.0	-69,793.0	-26,438.0	40,354.0	5,105.0
exports	1,254,394.0	1,370,930.0	1,722,657.0	1,875,219.0	514,947.0
imports	1,325,717.0	1,440,723.0	1,749,095.0	1,834,865.0	509,842.0
Services	21,850.8	13,236.7	12,539.3	19,411.8	6,186.8
credit	231,131.1	219,151.1	248,535.1	257,998.4	70,794.4
transport	56,560.5	60,556.3	72,308.9	78,763.0	19,563.3
travel	96,289.2	100,310.1	107,231.8	110,948.0	31,798.4
others	78,281.4	58,284.7	68,994.4	68,287.4	19,432.7
debit	209,280.3	205,914.4	235,995.8	238,586.6	64,607.6
transport	29,332.8	33,725.7	38,603.0	43,135.9	11,002.5
travel	51,549.3	54,419.2	58,398.0	57,777.6	18,672.8
others	128,398.2	117,769.5	138,994.8	137,673.1	34,932.3
Income	-115,615.0	-119,858.4	-157,772.9	-142,318.3	-56,544.0
credit	66,790.1	75,508.3	87,040.1	112,322.7	32,842.1
debit	182,405.1	195,366.7	244,813.0	254,641.0	89,386.1
Current transfers	28,709.1	15,800.1	4,323.4	20,882.3	-3,190.5
credit	46,709.0	46,976.7	46,777.3	75,639.7	13,199.9
debit	17,999.9	31,176.6	42,453.9	54,757.4	16,390.4
B. Capital account	-119.4	-82.2	-14,017.0	5,059.2	2,199.8
credit	221.0	198.2	5,608.2	5,731.1	2,631.2
debit	340.4	280.4	19,625.2	671.9	431.4
Total A + B	*-136,497.5*	*-160,696.8*	*-181,365.2*	*-56,611.0*	*-46,242.9*
C. Financial account	347,827.4	157,093.5	183,659.9	137,925.6	45,859.1
Direct investment	270,930.2	53,500.3	101,776.3	242,706.1	39,125.5
abroad	-6,759.3	-5,815.7	-26,067.3	-20,500.1	-5,235.1
equity capital and reinvested earnings	-5,376.8	-3,124.6	-20,260.0	-11,372.3	-4,564.6
other capital	-1,382.5	-2,691.1	-5,807.3	-9,127.8	-670.5
in the Czech Republic	277,689.5	59,316.0	127,843.6	263,206.2	44,360.6
equity capital and reinvested earnings	270,061.0	59,350.4	121,482.9	262,791.9	37,487.1
other capital	7,628.5	-34.4	6,360.7	414.3	6,873.5
Portfolio investment	-46,748.7	-35,719.1	59,380.4	-72,002.0	-11,128.3
assets	-75,602.1	-83,892.7	-63,897.3	-72,853.9	-13,533.5
equity securities	-7,807.9	5,630.5	-30,109.2	-26,036.2	-14,848.3
debt securities	-67,794.2	-89,523.2	-33,788.1	-46,817.7	1,314.8
liabilities	28,853.4	48,173.6	123,277.7	851.9	2,405.2
equity securities	-9,035.7	30,133.5	19,558.6	-36,408.9	734.0
debt securities	37,889.1	18,040.1	103,719.1	37,260.8	1,671.2
Financial derivatives	-4,281.7	3,860.1	-3,208.0	-2,801.8	-1,943.3
assets	-15,458.4	7,083.7	-15,565.8	-1,668.4	5,614.3
liabilities	11,176.7	-3,223.6	12,357.8	-1,133.4	-7,557.6
Other investment	127,927.6	135,452.2	25,711.2	-29,976.7	19,805.2
assets	133,121.8	67,071.3	-30,507.4	-104,419.1	3,663.7
long-term	28,711.4	1,141.3	20,434.2	-16,360.9	-2,171.5
CNB	—	—	-184.9	-176.3	—
commercial banks	5,271.7	-999.9	505.0	-24,664.6	-1,431.0
government	25,333.6	5,714.3	22,790.7	14,056.5	-539.6
other sectors	-1,893.9	-3,573.1	-2,676.6	-5,576.5	-200.9
short-term	104,410.4	65,930.0	-50,941.6	-88,058.2	5,835.2
commercial banks	122,163.8	44,971.2	-34,248.5	-87,102.6	8,096.6
government	-2,237.4	2,193.8	92.9	9.4	—
other sectors	-15,516.0	18,765.0	-16,786.0	-965.0	-2,261.4
liabilities	-5,194.2	68,380.9	56,218.6	74,442.4	16,141.5
long-term	2,853.8	26,361.6	36,550.9	50,238.9	11,485.5
CNB	-20.2	-20.4	-20.5	-19.1	-9.0
commercial banks	-8,059.2	-5,038.0	-1,410.8	311.0	4,343.2
government	-1,517.2	10,304.7	10,296.1	20,815.1	2,906.8
other sectors	12,450.4	21,115.3	27,686.1	29,131.9	4,244.5
short-term	-8,048.0	42,019.3	19,667.7	24,203.5	4,656.0
CNB	-24.3	-21.4	843.7	5,060.1	2,369.0
commercial banks	-3,871.2	37,899.4	-15,344.5	14,802.0	19,504.1
government	—	—	—	—	—
other sectors	-4,152.5	4,141.3	34,168.5	4,341.4	-17,217.1
Total A + B + C	*211,329.9*	*-3,603.3*	*2,294.7*	*81,314.6*	*-383.8*
D. Net errors and omissions, valuation changes	5,615.1	16,506.7	4,487.5	11,537.0	2,895.5
Total A + B + C + D	*216,945.0*	*12,903.4*	*6,782.2*	*92,851.6*	*2,511.7*
E. Change in reserves (- increase)	-216,945.0	-12,903.4	-6,782.2	-92,851.6	-2,511.7

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)] 30 Sep.
Assets	1,579,922.9	1,537,284.6	1,549,333.7	1,823,960.2	1,829,822.6
Direct investment abroad	44,397.1	58,581.5	84,087.4	104,235.0	125,670.0
- equity capital	39,472.1	50,965.5	70,664.0	81,315.0	102,630.0
- other capital	4,925.0	7,616.0	13,423.4	22,920.0	23,040.0
Portfolio investment	274,344.7	343,968.7	372,237.6	428,697.7	484,401.4
- equity securities	86,464.7	47,337.7	76,121.3	107,846.8	143,492.0
- debt securities	187,880.0	296,631.0	296,116.3	320,850.9	340,909.4
Financial derivatives	31,213.2	24,129.5	39,695.3	41,363.7	36,829.8
Other investment	515,356.2	419,090.0	417,071.9	522,961.8	494,557.5
long-term	179,639.6	157,598.6	118,432.7	136,313.4	134,056.2
- CNB	280.9	468.4	600.0	3,184.5	2,999.4
- commercial banks	67,966.9	66,121.3	58,137.8	83,230.4	90,548.8
- government	97,156.8	79,483.9	48,574.9	38,408.5	30,813.0
- other sectors	14,235.0	11,525.0	11,120.0	11,490.0	9,695.0
short-term	335,716.6	261,491.4	298,639.2	386,648.4	360,501.3
- CNB	376.7	98.8	71.7	71.1	169.9
- commercial banks	213,815.4	161,150.2	184,588.0	273,797.2	230,181.4
of which: gold and foreign exchange	163,032.9	115,884.8	128,119.8	197,959.6	133,529.9
- 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	130,150.0
CNB reserves	714,611.7	691,514.9	636,241.5	726,702.0	688,363.9
- gold	4,653.8	4,784.3	4,253.9	5,526.8	5,770.2
- SDR	137.1	238.7	118.0	289.8	342.4
- reserve position in the IMF	7,081.5	11,949.9	9,137.5	4,447.7	3,239.5
- foreign exchange	686,516.1	674,451.8	622,606.4	716,315.2	678,957.5
- other reserve assets	16,223.2	90.2	125.7	122.5	54.3
Liabilities	1,977,177.7	2,064,768.3	2,374,328.4	2,680,707.6	2,795,047.3
Direct investment in the Czech Republic	1,165,529.1	1,161,783.6	1,280,594.8	1,461,976.8	1,567,651.8
- equity capital	1,013,102.9	1,009,391.8	1,121,842.3	1,303,621.8	1,398,671.8
- other capital	152,426.2	152,391.8	158,752.5	158,355.0	168,980.0
Portfolio investment	201,120.0	223,620.4	381,019.4	437,806.0	433,182.7
- equity securities	128,097.7	140,788.6	208,872.1	220,495.8	210,181.5
- debt securities	73,022.3	82,831.8	172,147.3	217,310.2	223,001.2
Financial derivatives	22,671.9	19,448.3	31,806.1	30,672.7	24,807.1
Other investment	587,856.7	659,916.0	680,908.1	750,252.1	769,405.7
long-term	326,321.3	360,279.2	373,456.4	418,926.2	436,343.4
- CNB	114.5	96.1	70.2	47.8	27.5
- commercial banks	63,541.0	58,056.3	52,020.8	51,639.7	55,401.2
- government	9,475.8	22,456.0	32,065.4	52,372.7	58,348.7
- other sectors	253,190.0	279,670.8	289,300.0	314,866.0	322,566.0
short-term	261,535.4	299,636.8	307,451.7	331,325.9	333,062.3
- CNB	44.2	22.8	866.5	5,926.5	2,569.9
- commercial banks	176,196.2	208,534.0	185,025.2	201,239.4	196,217.4
- government	—	—	—	—	—
- other sectors	85,295.0	91,080.0	121,560.0	124,160.0	134,275.0
Net investment position	-397,254.8	-527,483.7	-824,994.7	-856,747.4	-965,224.7

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)] 30 Sep.
Debt in convertible currencies	813,305.2	895,139.6	1,011,807.9	1,125,917.3	1,161,386.9
of which:					
Long-term	498,833.8	535,995.9	667,327.6	772,917.0	798,744.7
by debtor					
- CNB	114.5	96.1	70.2	47.8	27.5
- commercial banks	80,063.7	73,276.4	64,346.5	65,418.8	67,895.1
- government	47,701.3	69,029.9	147,729.1	221,054.0	234,570.1
- other sectors	370,954.3	393,593.5	455,181.8	486,396.4	496,252.0
by creditor					
- foreign banks	230,589.8	251,535.3	269,081.3	284,541.7	292,972.5
- 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	106,732.2
- suppliers and direct investors	118,829.4	109,287.9	143,301.2	158,690.0	163,180.0
- other investors	77,772.7	91,393.1	170,082.7	221,528.5	226,304.5
Short-term	314,471.4	359,143.7	344,480.3	353,000.3	362,642.2
by debtor					
- CNB	44.2	22.8	866.5	5,926.5	2,569.9
- commercial banks	177,474.4	210,017.0	188,495.9	202,540.6	199,937.3
- government	761.0	710.0	3,334.6	1,102.4	470.0
- other sectors	136,191.8	148,393.9	151,783.3	143,430.8	159,665.0
by creditor					
- foreign banks	168,200.7	218,436.1	202,372.6	197,384.4	199,884.4
- multilateral institutions	—	—	861.3	5,918.8	2,561.5
- suppliers and direct investors	112,256.8	105,563.9	98,611.3	97,025.0	107,880.0
- other investors	34,013.9	35,143.7	42,635.1	52,672.1	52,316.3
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	1,161,386.9
of which:					
- long-term	498,833.8	535,995.9	667,327.6	772,917.0	798,744.7
- short-term	314,471.4	359,143.7	344,480.3	353,000.3	362,642.2
Total long-term debt	498,833.8	535,995.9	667,327.6	772,917.0	798,744.7
of which:					
- IMF loans	—	—	—	—	—
- liabilities of government sector and guaranteed by government, and liabilities of entities majority owned by state	207,325.2	222,120.9	272,202.1	322,318.0	321,077.9
- liabilities of entities with majority private capital	291,508.6	313,875.0	395,125.5	450,599.0	477,666.8

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	10 - 12
CZK exchange rate against selected currencies					
- annual/quarterly averages					
1 EUR	30.81	31.84	31.90	29.78	28.05
1 USD	32.74	28.23	25.70	23.95	21.77
100 SKK	72.22	76.75	79.69	77.15	78.08
	12	**12**	**12**	**12**	**12**
- monthly averages					
1 EUR	31.19	32.31	30.65	28.98	27.78
1 USD	30.65	26.32	22.87	24.44	21.02
100 SKK	74.67	78.57	78.81	76.51	79.44
	31 Dec.	**31 Dec.**	**31 Dec.**	**30 Dec.**	**29 Dec.**
- last day of the month					
1 EUR	31.60	32.41	30.47	29.01	27.50
1 USD	30.14	25.65	22.37	24.59	20.88
100 SKK	75.18	78.71	78.63	76.57	79.86

B. NOMINAL EFFECTIVE RATE	2002	2003	2004	2005	2006
CZK nominal effective exchange rate (percentages)					
(2000=100)					
weights - foreign trade turnover	116.5	116.0	116.3	123.5	129.3
weights - foreign trade turnover SITC 5-8	116.1	115.6	115.5	122.8	128.7

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
					11
CZK real effective exchange rate (percentages)					
(2000=100)					
a) industrial producer prices					
weights - foreign trade turnover	115.2	111.3	114.0	118.9	120.8
weights - foreign trade turnover SITC 5-8	115.9	112.0	115.4	121.1	123.6
b) consumer prices					
weights - foreign trade turnover	116.7	112.9	113.0	118.9	124.2
weights - foreign trade turnover SITC 5-8	117.5	113.7	114.1	120.7	126.7

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

Table 16

PUBLIC FINANCES					in CZK billions
	2002 1 - 12	2003 1 - 12	2004 1 - 12	2005 1 - 12	2006 1 - 12
STATE BUDGET					
Total revenue	705.0	699.7	769.2	866.5	923.3
Tax revenue	627.4	667.5	716.7	770.4	802.0
Taxes on income, profits and capital gains	159.0	172.9	180.7	195.0	187.2
Domestic taxes on goods and services	186.9	198.4	223.2	250.4	266.3
- value-added taxes	118.1	125.6	140.4	146.8	153.7
- excises	68.9	72.9	82.8	103.6	112.6
Taxes on property	7.9	8.8	10.4	8.1	8.5
Social and health security contributions and payroll taxes	258.5	272.4	293.3	311.2	333.8
Non-tax and capital incomes and received subsidies	77.7	32.2	52.5	96.1	121.4
Total expenditure	750.8	808.7	862.9	922.8	1,020.6
Current expenditure	697.3	745.4	796.8	840.8	912.1
Capital expenditure	53.5	63.3	66.1	82.0	108.5
Public budgets (balance in IMF GFS methodology)	-11.5	-127.7	-89.4	0.6	__
state budget	-45.7	-104.9	-65.0	-61.1	-97.3
local budget	-4.3	-2.9	-8.9	7.8	__
state financial assets	__	__	__	__	__
state funds	12.3	6.9	-11.7	-0.5	__
Land Fund	-0.5	-0.1	0.2	1.6	__
National Property Fund	28.4	-27.4	-4.2	51.5	__
health insurance companies	-1.2	0.1	0.2	0.5	__
others	-0.5	0.6	0.0	0.8	__

Table 17

CAPITAL MARKET

last day of the month in points

A. STOCK MARKET INDICES	2002 12	2003 12	2004 12	2005 12	2006 12
BCPP					
PX	460.7	659.1	1,032.0	1,473.0	1,588.9
PX-D	1,166.4	1,642.7	2,551.1	3,731.4	__
PX-GLOB	576.8	816.9	1,232.7	1,811.3	1,987.4
RM-SYSTÉM					
PK-30	672.5	947.5	1,443.5	2,365.0	2,595.3

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 12
BCPP					
Monthly trade volumes	109,264.8	98,640.0	90,610.5	96,160.5	112,414.9
of which:					
a) shares	17,089.3	28,296.0	46,210.3	56,180.3	58,915.7
b) units	0.0	0.0	0.0	0.0	15.0
c) bonds	92,175.5	70,344.0	44,400.2	39,980.2	53,484.3
RM-SYSTÉM					
Monthly trade volumes	4,412.1	1,103.0	335.8	286.7	523.1
of which:					
a) shares	298.4	1,082.5	332.7	220.9	440.2
b) units	1.0	3.7	3.1	0.0	1.1
c) bonds	4,112.7	16.8	0.0	65.8	81.7

Table 18

CNB MONETARY POLICY INSTRUMENTS

	2W repo rate (%)	Discount rate (%)	Lombard rate (%)	Minimum reserve requirement for primary deposits (%)	
				Banks	Building societies and ČMZRB
1999					
18 January	8.75	—	—	—	—
28 January	—	—	—	5.00	—
29 January	8.00	—	—	—	—
12 March	7.50	6.00	10.00	—	—
9 April	7.20	—	—	—	—
4 May	6.90	—	—	—	—
25 June	6.50	—	—	—	—
30 July	6.25	—	—	—	—
3 September	6.00	5.50	8.00	—	—
5 October	5.75	—	—	—	—
7 October	—	—	—	2.00	2.00
27 October	5.50	5.00	7.50	—	—
26 November	5.25	—	—	—	—
2000	No changes made				
2001					
23 February	5.00	4.00	6.00	—	—
27 July	5.25	4.25	6.25	—	—
30 November	4.75	3.75	5.75	—	—
2002					
22 January	4.50	3.50	5.50	—	—
1 February	4.25	3.25	5.25	—	—
26 April	3.75	2.75	4.75	—	—
26 July	3.00	2.00	4.00	—	—
1 November	2.75	1.75	3.75	—	—
2003					
31 January	2.50	1.50	3.50	—	—
26 June	2.25	1.25	3.25	—	—
1 August	2.00	1.00	3.00	—	—
2004					
25 June	2.25	1.25	3.25	—	—
27 August	2.50	1.50	3.50	—	—
2005					
28 January	2.25	1.25	3.25	—	—
1 April	2.00	1.00	3.00	—	—
29 April	1.75	0.75	2.75	—	—
31 October	2.00	1.00	3.00	—	—
2006					
28 July	2.25	1.25	3.25	—	—
29 September	2.50	1.50	3.50	—	—

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 Q3
Gross domestic product					
- in CZK millions	2,285,488	2,367,818	2,467,615	2,617,608	702,574
- percentages	1.9	3.6	4.2	6.1	5.8
Final consumption					
- in CZK millions	1,709,342	1,817,625	1,832,424	1,873,847	487,140
- percentages	3.5	6.3	0.8	2.3	2.0
of which:					
Households					
- in CZK millions	1,187,163	1,258,158	1,290,086	1,326,376	355,450
- percentages	2.2	6.0	2.5	2.8	4.0
Government					
- in CZK millions	509,591	545,999	528,767	534,005	129,323
- percentages	6.7	7.1	-3.2	1.0	-2.6
Non-profit institutions					
- in CZK millions	12,586	13,362	14,576	15,104	4,034
- percentages	-0.9	6.2	9.1	3.6	8.4
Gross capital formation					
- in CZK millions	720,002	709,600	768,013	780,361	227,223
- percentages	4.6	-1.4	8.2	1.6	13.6
of which:					
Fixed capital					
- in CZK millions	686,128	689,117	721,822	731,246	198,507
- percentages	5.1	0.4	4.7	1.3	7.2
Changes in inventories					
- in CZK millions	30,435	15,642	43,266	46,734	28,048
Acquisitions less disposals of valuables					
- in CZK millions	3,439	4,841	2,925	2,381	668
- percentages	33.0	40.8	-39.6	-18.6	19.0
Foreign trade					
of which:					
Exports of goods					
- in CZK millions	1,354,163	1,479,795	1,820,657	2,031,968	564,365
- percentages	5.9	9.3	23.0	11.6	12.8
Exports of services					
- in CZK millions	222,147	212,807	231,549	236,721	64,590
- percentages	-15.7	-4.2	8.8	2.2	2.3
Imports of goods					
- in CZK millions	1,489,963	1,623,393	1,943,966	2,054,029	572,051
- percentages	4.6	9.0	19.7	5.7	11.8
Imports of services					
- in CZK millions	231,687	235,915	253,370	248,900	66,602
- percentages	7.7	1.8	7.4	-1.8	2.4
Final domestic demand					
- in CZK millions	2,395,470	2,506,742	2,554,246	2,605,093	685,647
- percentages	3.9	4.6	1.9	2.0	3.5
Aggregate domestic demand					
- in CZK millions	2,429,344	2,527,225	2,600,437	2,654,208	714,363
- percentages	3.8	4.0	2.9	2.1	5.5
Gross domestic product at current prices					
- in CZK millions	2,464,432	2,577,110	2,781,060	2,970,261	813,125
- percentages	4.8	4.6	7.9	6.8	8.4

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 Q3
Current income	6.4	5.9	4.9	4.6	5.2
of which:					
- gross operating surplus and mixed income	2.4	7.7	5.7	0.1	0.4
- compensation of employees	8.5	5.5	5.7	6.3	6.3
- property income	-0.9	5.3	-1.0	4.0	8.1
- social benefits other than social transfers in kind	8.0	3.6	3.4	5.1	6.6
- other current transfers	4.1	10.9	2.2	3.9	6.8
Current expenditure	8.4	9.5	7.5	4.6	7.1
of which:					
- property income	15.1	21.3	12.4	4.0	28.5
- current taxes on income, wealth, etc.	8.2	12.1	7.7	1.9	1.3
- social contributions	8.9	7.2	8.3	6.5	7.5
- other current transfers	4.7	12.5	2.8	-0.1	8.3
Gross disposable income	5.6	4.3	3.6	4.7	4.4
Change in net equity of households in pension funds reserves	22.6	15.4	29.1	11.1	24.0
Individual consumption expenditure	3.5	6.5	5.6	4.5	6.8
Gross saving	31.8	-15.5	-17.8	7.7	-48.5
Gross saving rate	9.90	8.03	5.89	6.06	2.02
(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 Q3
Whole-economy nominal wage	7.0	6.4	6.2	5.5	6.1
Business sector	6.3	5.5	6.3	5.3	6.3
Non-business sector	9.8	9.8	5.7	6.7	5.4
Whole-economy real wage	5.1	6.3	3.3	3.5	3.1
Business sector	4.4	5.4	3.4	3.3	3.3
Non-business sector	7.9	9.7	2.8	4.7	2.4

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 12
Registered job applicants (thousands)	514.4	542.4	541.7	510.4	448.5
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
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	1.6
c) average for 2000 = 100	2.3	1.9	7.7	10.9	12.7
d) December 1999 = 100	5.8	5.4	11.4	14.7	16.5
Construction work prices					
a) previous month = 100	0.2	0.2	0.4	0.2	0.3
b) same period of last year = 100	2.7	2.2	3.7	3.0	2.9
c) average for 2000 = 100	6.9	9.2	13.3	16.6	20.0
d) December 1999 = 100	9.3	11.7	15.8	19.3	22.7
Agricultural producer prices					
b) same period of last year = 100	-9.5	-2.9	8.1	-9.2	2.2
of which:					
crop products					
b) same period of last year = 100	-4.6	-1.0	11.6	-25.0	13.3
livestock products					
b) same period of last year = 100	-12.1	-4.0	6.1	0.4	-2.9
Market services prices					
a) previous month = 100	0.3	0.0	0.2	0.1	0.3
b) same period of last year = 100	3.2	1.6	2.3	1.9	3.7
c) average for 2000 = 100	7.3	9.0	11.5	13.7	17.9
d) December 1999 = 100	8.0	9.7	12.2	14.4	18.6

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	-3.2	0.0
Public debt	17.2	18.0	21.5	23.7	25.7
Debt in convertible currencies	34.5	33.0	34.7	36.4	37.9
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	67.1

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