INFLATION REPORT / JULY

2007

CNB CZECH NATIONAL BANK

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TABLES IN THE TEXT

ARA	Amsterdam-Rotterdam-Antwerp
BCPP	Prague Stock Exchange
CIF	cost, insurance and freight
ČMZRB	Czech-Moravian Guarantee and Development Bank
CNB	Czech National Bank
COICOP	Classification of Individual Consumption According to Purpose
CPI	consumer price index
CZK	Czech koruna
CZSO	Czech Statistical Office
ECB	European Central Bank
ERM II	Exchange Rate Mechanism
EU	European Union
EUR	euro
EURIBOR	Euro Interbank Offered Rate
FDI	foreign direct investment
Fed	Federal Reserve System (the central banking system in the USA)
FOB	free on board
FOMC	Federal Open Market Committee
FRA	forward rate agreement
GDP	gross domestic product
GFS	Government Finance Statistics
HICP	Harmonised Index of Consumer Prices
HUF	Hungarian forint
ILO	International Labour Organization
IMF	International Monetary Fund
IRS	interest rate swap
LFS	Labour Force Survey
LIBOR	London Interbank Offered Rate
M1, M2	monetary aggregates
MFIs	monetary financial institutions
MNB	Hungarian National Bank
MLSA	Ministry of Labour and Social Affairs
NBS	National Bank of Slovakia
NCG	net credit to government
NDAs	net domestic assets
NEAs	net external assets
NPISHs	non-profit institutions serving households
OMFIs	other monetary financial institutions
O/N	overnight
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

Price indices used for the evaluation of inflation	(Box)	April 1998
Analysis of the money supply trend	(Box)	July 1999
Revisions to the statistical data on GDP	(Box)	July 1999
Measuring the inflation expectations of the financial market	(Annex)	October 1999
Oil prices and their impact on inflation	(Box)	July 2000
The effect of oil price changes on the balance of trade	(Box)	October 2000
The methodological framework for evaluating wage developments relative to inflation	(Box)	January 2001
The CNB's monetary policy rates	(Box)	April 2001
The setting of the inflation target for 2002–2005	(Annex)	April 2001
Harmonisation of the reserve requirements with European Central Bank standards	(Annex)	April 2001
Escape clauses pertaining to the new inflation target	(Annex)	July 2001
Changes in economic growth forecasts in the eurozone, Germany, the USA and Japan for 2001 and 2002	(Annex)	October 2001
Strategy for dealing with the exchange rate effects of capital inflows from privatisation of state property and from other foreign exchange revenues of the state	(Annex)	January 2002
Assessment of fulfilment of the CNB's net inflation target in December 2001	(Annex)	January 2002
Prediction of external variables	(Box)	April 2002
Estimated capital flows in 2002 and 2003 and their effect on the exchange rate	(Box)	April 2002
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The CNB changes its type of inflation forecast	(Box)	July 2002
An assessment of the effect of the August floods on Czech economic growth	(Box)	October 2002
The financial conditions of the Czech Republic's accession to the EU	(Box)	January 2003
Implications of the unexpectedly slow growth in regulated prices	(Box)	January 2003
The Czech Republic and the euro – Draft accession strategy	(Annex)	January 2003
Fiscal consolidation and its effect on economic growth	(Annex)	January 2003
Price deregulation in the period of transformation of the Czech economy	(Box)	April 2003
Revisions to the March 2003 GDP figures	(Box)	April 2003
Credit to households	(Box)	July 2003
The withdrawal of 10- and 20-heller coins and its possible impact on prices	(Box)	July 2003
Indirect taxes and the inflation forecast	(Box)	July 2003
Changes to the methodology for surveying inflation expectations	(Box)	July 2003
ERM II and the exchange-rate convergence criterion	(Annex)	July 2003
Use of the output gap indicator at the CNB	(Box)	October 2003
Monetary policy in the CNB's macroeconomic forecast	(Box)	October 2003
The Czech Republic's euro-area accession strategy	(Annex)	October 2003
Short-run food price prediction methods	(Box)	January 2004
Monetary conditions	(Box)	April 2004
The CNB's inflation target from January 2006	(Annex)	April 2004
The exchange rate in the CNB's forecasting system	(Box)	July 2004
The CNB has fully integrated into the European System of Central Banks	(Annex)	July 2004
Petrol prices and their impact on inflation in the Czech Republic	(Box)	October 2004
Indicators of households' financial situation	(Box)	October 2004
GDP data revision	(Box)	October 2004
The structure of lending	(Box)	January 2005
Uncertainty regarding the evolution of public finances in 2005 and 2006	(Box)	January 2005
Inflation expectations in the CNB's modelling system	(Box)	January 2005
Assessment of the fulfilment of the Maastricht convergence criteria and the degree of alignment of the Czech economy with the euro area	(Annex)	January 2005
The transmission of external cost shocks into domestic prices in 2003–2005	(Box)	April 2005
The effect of the exchange rate on inflation	(Box)	April 2005
The Czech National Bank's position on the revision of the Stability and Growth Pact	(Annex)	April 2005
The effect of EU accession on prices and inflation expectations	(Box)	July 2005
Foreign trade in the first year after the Czech Republic's accession to the EU	(Box)	July 2005
Financial flows between the Czech Republic and the European Union	(Box)	July 2005
The effect of world energy prices on consumer prices	(Box)	October 2005

The performance of large non-financial corporations 1998–2004	(Box)	October 2005
Potential output in the CNB's forecasting system	(Box)	October 2005
Fiscal policy in the CNB's modelling system	(Box)	January 2006
Assessment of the fulfilment of the Maastricht Convergence criteria and the degree of economic alignment of the Czech Republic with the euro area	(Annex)	January 2006
Implications of household debt for consumption	(Box)	April 2006
Effective indicators of external developments	(Box)	July 2006
Oil and petrol prices in the CNB forecast	(Box)	July 2006
The role of monetary aggregates in the CNB's forecasts	(Box)	October 2006
Assessment of the fulfilment of the Maastricht convergence criteria and the degree of economic alignment of the Czech Republic with the euro area	(Annex)	October 2006
Employment of foreign nationals	(Box)	January 2007
The extension of the core prediction model to include the effect of real wages	(Box)	January 2007
The new consumer basket as from January 2007	(Box)	April 2007
Financing of non-financial corporations	(Box)	April 2007
The application of escape clauses to indirect tax changes	(Box)	April 2007
The CNB's new inflation target and changes in monetary policy communication	(Annex)	April 2007
The relationship between interest rates and the structure of new loans for house purchase	(Box)	July 2007
The CNB's new approach to the monitoring of inflation expectations of households in the Czech Republic	(Box)	July 2007

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 correspond to the message of the forecast. Information on the Bank Board's discussions over the past three months and on the reasons for its monetary policy measures in that period is given in the minutes of the Bank Board meetings at the end of this Inflation Report.

This Inflation Report was approved by the CNB Bank Board on 2 August 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/. Underlying data for the tables and charts given in the text of this Inflation Report are published on the same internet address.

Chart I.1
Inflation was in the lower half of the inflation-target tolerance band in 2007 Q2
(annual percentage changes in CPI)

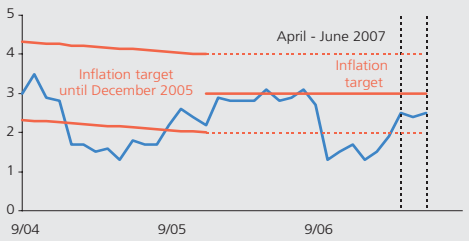


Table I.1
The Czech economy continued to grow at more than six per cent pace in 2007 Q1
(annual percentage changes unless otherwise indicated)

	03/07	04/07	05/07	06/07
Consumer price inflation	1.9	2.5	2.4	2.5
Industrial producer price inflation	3.6	3.7	4.1	4.6
Money supply growth (M2)	10.6	11.4	12.1	-
3M PRIBOR [a] (in per cent)	2.6	2.6	2.8	2.9
CZK/EUR exchange rate [a] (level)	28.06	28.01	28.23	28.55
State budget balance since January [b], (CZK bn)	11.3	-17.0	-26.0	1.3
GDP growth at constant prices [c]	6.1			-
Unemployment rate [d] (in per cent)	7.3	6.7	6.4	6.3

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 increased in 2007 Q2 and neared the inflation target (see Chart I.1). The continuing buoyant growth of the Czech economy in 2007 Q1 fostered rising employment and a further decline in unemployment (see Table I.1). Money market interest rates rose during 2007 Q2. The koruna's exchange rate depreciated against both major world currencies.

Annual consumer price inflation rose by more than 0.5 percentage point in April and was flat in the remaining months of Q2. The rise in inflation was due mainly to the growing effect of changes to indirect taxes and adjusted inflation excluding fuels. The upswing in annual consumer price inflation was, to a lesser extent, also due to food prices and regulated prices. Fuel prices continued to fall year on year in Q2, albeit at a slower pace.

Annual GDP growth exceeded 6% in 2007 Q1, as in the previous two years or so. The growth of the Czech economy continued to be based primarily on household consumption and gross capital formation. On the other hand, the contribution of government consumption decreased and the effect of the real balance of foreign trade on the growth of the Czech economy was negative for the first time in three years.

The labour market situation was little changed in 2007 Q1. Annual employment growth picked up pace modestly compared to the previous quarter and continued to foster a decrease in the unemployment rate, which continued falling in Q2. In this situation, annual nominal and real wage growth rose considerably. As in the previous period, wages in the business sector grew appreciably faster than in the non-business sector.

Interest rates on the money market increased in 2007 Q2, especially at longer maturities. Nervousness on the money market ahead of the CNB Bank Board's April and especially May meetings led to increased rate volatility at the shortest maturities. The money market was affected in particular by a shift in market expectations towards an earlier or more sizeable increase in interest rates.

The koruna's exchange rate depreciated against both the euro and the dollar in the final two months of 2007 Q2. This depreciation was due primarily to the negative interest rate differential and increased interest in the sale of korunas connected with dividend payments and their subsequent transfer abroad. Unlike in the previous period, the individual currencies of the Central European region displayed very mixed trends.

The monetary policy decision-making of the CNB Bank Board in 2007 Q2 was based on the inflation forecast described in the April Inflation Report. Given the monetary policy transmission lag, the Board focused on hitting the inflation target at roughly the 12–18 month horizon, i.e. in the second and third quarters of 2008. According to the forecast, inflation was expected to be in the upper half of the tolerance band for the target inflation in this period. Inflation adjusted for the first-round impacts of changes to indirect taxes, to which monetary policy does not react, was expected to be slightly below the inflation target at the monetary policy horizon. Consistent with the baseline scenario was a gradual rise in nominal interest rates over the entire forecast horizon.

The Bank Board left monetary policy interest rates unchanged in April. In May it decided to raise rates by 0.25 percentage point with effect from 1 June 2007. This decision was consistent with the macroeconomic forecast and its risks, which gradually shifted to the upside in the course of Q2. Despite holding various different views on the effects of individual factors on inflation, the board members concurred that the shift in the risks of the forecast was associated with domestic rather than external factors. The Bank Board's vote was tied, so, in compliance with

the CNB's Rules of Procedure, the chairman cast the deciding vote. At its meeting at the end of June, the Bank Board decided by a majority vote to leave monetary policy interest rates unchanged.

Section IV of this Inflation Report describes the CNB's new forecast, which takes into account new information obtained since the April forecast was drawn up. New data on domestic economy activity confirm that the real economy is inflationary. The real marginal cost gap is currently positive. The real economy will be inflationary in the remainder of 2007; this effect will weaken slightly in 2008.

The inflationary signals from the Czech and external economies led to an increase in the inflation forecast. Higher inflation will be fostered in the near future by higher-than-previously-forecasted import prices and in the longer run by the lagged inflationary effects of the real economy. The inflationary effects of the real economy, growth in regulated prices, an increasing contribution from changes to indirect taxes and growth in import prices will thus be the main factors underlying the rise in inflation from its current values. According to the current forecast, headline inflation will be slightly above the upper margin of the tolerance band for the inflation target at the monetary policy horizon (see Chart I.2).

The mechanism of caveats applies as usual to the first-round effects of changes to indirect changes, whose effect at the forecast horizon is pronounced. Adjusted for these effects, monetary-policy relevant inflation[1] is in the upper half of the tolerance band for the inflation target at the monetary policy horizon (see Chart I.3). Consistent with the macroeconomic forecast and its assumptions is growth in nominal interest rates. Based on this forecast, the Bank Board decided to increase interest rates by 0.25 percentage point in July.

Along with the baseline scenario, an alternative scenario was drawn up capturing the uncertainty concerning inflation expectations. The alternative scenario considers the situation where inflation expectations are affected by consumers' long-term experience with low adjusted inflation excluding fuels and low food price inflation. This experience may lead to lower expected inflation than in the baseline scenario of the forecast and to the absence of the pass-through of the tax changes to inflation expectations. In the alternative scenario, headline inflation and monetary-policy relevant inflation are lower, and the interest rate response is somewhat softer, than in the baseline scenario.

Chart I.2
The inflation forecast lies slightly above the upper boundary of the inflation-target tolerance band at the monetary policy horizon
(annual percentage changes in CPI)

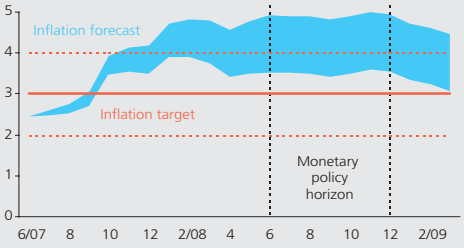
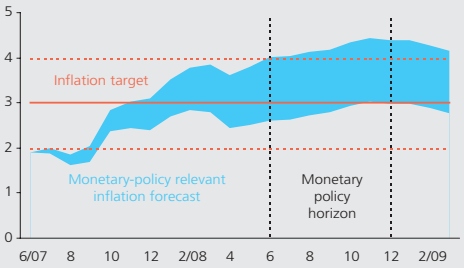


Chart I.3
Monetary-policy relevant inflation lies in the upper half of the inflation-target tolerance band at the monetary policy horizon
(annual percentage changes)



1 Monetary-policy relevant inflation = inflation to which monetary policy reacts. It is defined as headline inflation adjusted for first-round effects of changes to indirect taxes

Chart II.1
Annual inflation increased overall in 2007 Q2
(annual percentage changes)

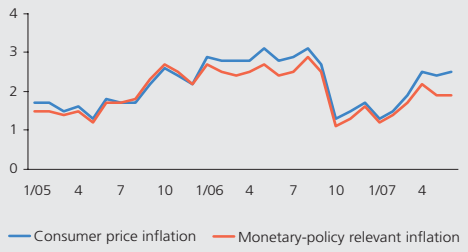


Table II.1
Inflation rose in most consumer basket categories in 2007 Q2
(annual percentage changes)

	3/07	4/07	5/07	6/07
CONSUMER PRICES	1.9	2.5	2.4	2.5
of which:				
food and non-alcoholic beverages	3.3	4.8	3.9	2.6
alcoholic beverages and tobacco	5.3	6.7	8.3	9.7
clothing and footwear	-1.8	-0.8	-0.4	0.0
housing, water, electricity, gas and other fuels	2.3	2.5	2.7	2.8
furnishings, household equipment and routine maintenance of the house	-0.5	-0.3	-0.1	0.0
health	3.7	6.4	5.6	4.8
transport	-0.6	-0.8	-0.6	0.1
communication	3.8	5.9	0.3	0.2
recreation and culture	0.7	0.8	0.4	0.8
education	2.7	2.7	2.7	2.7
hotels and restaurants	2.4	2.5	2.6	2.7
miscellaneous goods and services	2.4	2.3	2.3	2.2

Chart II.2
Consumer price inflation continued to be driven by food and housing prices in 2007 Q2
(contributions in percentage points; including first-round impacts of tax changes; June 2007)

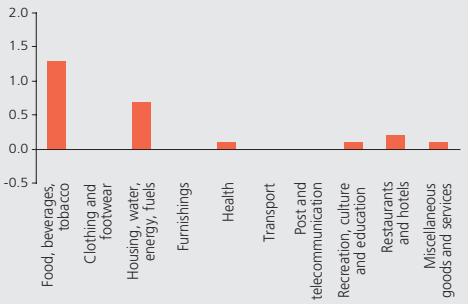
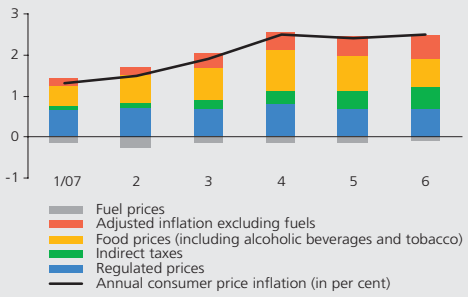


Chart II.3
Market prices accounted for roughly half of the consumer price inflation
(contributions in percentage points; annual percentage changes)



II.1 PAST INFLATION DEVELOPMENTS

The rise in inflation[2] observed since November last year continued into 2007 Q2 (see Chart II.1). Annual consumer price inflation picked up to 2.5% in June, i.e. by 0.6 percentage point compared to March. This distinct pick-up in inflation was due mainly to the impact of increases in excise duties on tobacco prices.[3] Prices in another seven categories recorded gradual growth or a slowing decline, and not only for services, but also for durable goods. However, annual consumer price inflation continued to be more than two-thirds driven by prices in just two categories – food[4] and housing, as shown in Chart II.2. The inflation rate,[5] which is affected by inflation developments in the longer run, decreased very moderately in 2007 Q2 to stand at 2.1% in June.

Charts II.1 and II.3 illustrate the effect of indirect taxes on consumer price inflation since the start of 2007. Both charts show that indirect taxes had a significantly increased effect on consumer prices in Q2. These taxes are being adjusted as part of the process of harmonisation of excise duties in EU countries. In these circumstances, annual monetary-policy relevant inflation,[6] which is the main inflation indicator for the CNB's monetary policy decision-making, was lower than headline inflation throughout Q2 (by 0.6 percentage point in June, i.e. 1.9%; see Chart II.1).

The inflation developments in 2007 Q2 again went on amid contrary movements in prices of significant energy and raw material inputs. Oil prices and the related koruna import prices of mineral fuels continued to fall year on year, while metal prices on world markets and domestic electricity prices showed rapid annual growth. This contrary trend in input prices passed through variously to producers' costs across the individual branches. Amid favourable demand, producer price inflation in industry picked up pace. Agricultural producer price inflation slackened, but remained high. Construction work prices, after rising significantly in March, were higher than in the previous period.

By the CNB's estimation, the economy has been exceeding the potential, non-accelerating inflation level of output since 2005 Q4. Consumer demand continued growing and developments on the labour market suggested faster growth in nominal unit wage costs. Developments in some price categories indicated upward pressures on prices stemming from the real economy, although this phenomenon was not seen across the board.

The rising domestic energy prices passed through significantly and directly to housing prices only. Food price inflation (adjusted for tax changes) was affected primarily by specific factors affecting agricultural producer prices. However, the gradually strengthening price growth or weakening annual price decline in most categories of the consumer basket may be a sign that the strong consumer demand is having an increasing inflationary effect. The consumer demand effect may be one

2 Measured by annual growth in consumer prices.
3 Tobacco prices were affected by the lagged effect of increases in excise duty introduced on 1 April 2006 and 1 March 2007.
4 Consolidated category of prices of food and non-alcoholic beverages and prices of alcoholic beverages and tobacco.
5 The inflation rate expressed as the increase in the average consumer price index (basic) for the 12 last months relative to the average for the previous 12 months.
6 Monetary-policy relevant inflation = inflation to which monetary policy reacts. It is defined as headline inflation adjusted for the first-round impacts of changes to indirect taxes. See Box 3 *The application of escape clauses to indirect tax changes* in the April 2007 Inflation Report.

of the reasons for the halt in the long-running decline in prices of durable goods, although this might also be partly due to the koruna-euro exchange rate, acting via import prices.

Food prices[7] grew faster overall in 2007 Q2 than in the previous quarter even after adjustment for the tax changes. In June their annual growth was lower than in March (2.7%), but in April and May it was well above the Q1 outturns. The upswing in food price inflation was due mainly to a rise in bread prices (of 8.4% in June), apparently linked with very rapid growth in prices of agricultural products of vegetable origin (cereals). Fruit prices also rose markedly (by 7.2%). By contrast, prices of vegetables (including potatoes), which display considerable volatility, fell sharply from the high annual growth figures recorded at the start of the year. Falling prices were also recorded by some other foods (oils, fats, etc.).

Prices of non-food commodities, as measured by adjusted inflation excluding fuels, also went up in 2007 Q2. Nevertheless, their overall annual growth remained modest (1% in June). Chart II.5 shows that the long-running subdued growth in prices of non-food commodities is a result of falling prices of other tradable goods[8] and rising prices of non-tradable goods.

Prices of non-tradable goods, which are affected solely by the domestic competitive environment (primarily services), continued to display relatively stable growth in 2007 Q2. They recorded annual growth of 2.8% in June, only slightly lower than in March. Services in the health, education and housing categories continued to show the fastest growing prices. By contrast, prices of tradable goods are influenced mainly by the external competitive environment, which affects domestic prices via import prices of consumer goods. They are thus considerably affected by prices of consumer products abroad and by the koruna's exchange rate. As mentioned in previous Inflation Reports, prices of tradable goods have been displaying an annual decline since 2001. In 2007 Q2, this decline weakened noticeably, falling below 2% (to 1.6% in June) for the first time in a long time. This was mainly due to a gradual moderation of the year-on-year appreciation of the koruna-euro exchange rate, culminating in a year-on-year stagnation in June. This change is likely to have contributed to the fact that the long-running consumer price decline in the categories of clothing and footwear and household equipment and furnishings halted at the end of Q2 and prices were flat.

The other price areas also recorded no major changes in 2007 Q2 compared to the previous quarter. Fuel prices continued to fall year on year, although this fall moderated further (to -1.9% in June) in line with oil prices on world markets. Annual growth in regulated prices eased somewhat in 2007 Q2 (to 4% in June). In April their growth picked up appreciably as a result of a rise in prices of regulated items of natural gas and supplementary payments for medicines (to 4.7%), but in the following months it fell back to the end-Q1 level.

Turning to international comparisons, annual HICP inflation in the Czech Republic rose above the average inflation level in the EU countries in 2007 Q2. According to the latest Eurostat figures for June, annual HICP inflation in the EU countries was 2.1%, or 0.5 percentage point lower than that in the Czech Republic.

CHART II.4
Food prices rose faster overall in 2007 Q2 than in Q1
(annual percentage changes)

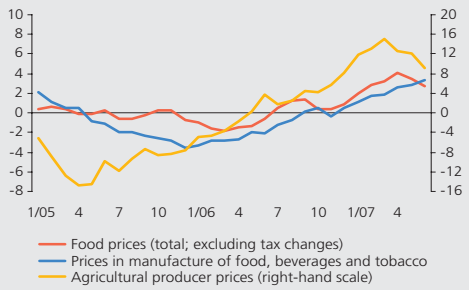


CHART II.5
Growth in prices of non-food commodities was still generally moderate
(annual percentage changes; excluding tax effects)

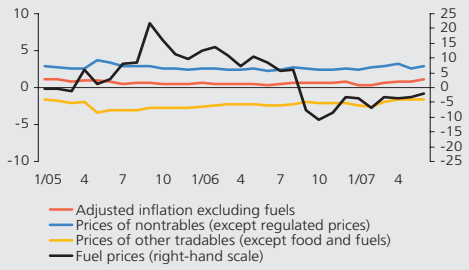
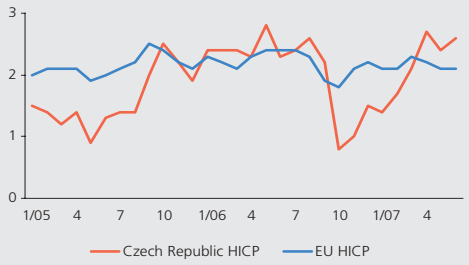


CHART II.6
Inflation in the Czech Republic was above the average level in the EU countries in 2007 Q2
(annual percentage changes)



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

8 Excluding food and fuels.

II.2 FULFILMENT OF THE INFLATION TARGET

Headline inflation was in the lower half of the tolerance band of the CNB's inflation target in 2007 Q2 (see Chart I.1). This section of the Inflation Report briefly analyses the contribution of the CNB's monetary policy to this situation.

To assess the effect of monetary policy on the fulfilment of the inflation target one needs to analyse retrospectively the forecasts and the Bank Board's decisions based thereon in the relevant period. As monetary policy is focused on hitting the inflation target at the 12–18 month horizon, the key period for the fulfilment of the inflation target in 2007 Q2 is roughly from October 2005 to June 2006. For comprehensibility, the analysis of the accuracy of the forecasts is limited here to a comparison of the forecast drawn up in January 2006 with inflation in 2007 Q2.

According to the January 2006 forecast, headline inflation was expected to be slightly below the inflation target until the end of 2006 and to rise slightly above it during 2007 H1 (see Chart II.7). The significant expected inflation factors were regulated prices of energy for households and the price impacts of the increases in indirect taxes on cigarettes and their effect on inflation expectations, while the real economy was expected to have a slightly anti-inflationary effect. The real monetary conditions were expected to have a moderately easy effect, thanks to the exchange rate component. The interest rate component was expected to have a roughly neutral effect.

Up to and including 2006 Q3, headline inflation developed in line with the forecast. Subsequently, however, it was considerably lower. In 2007 Q2, the deviation primarily reflected adjusted inflation excluding fuels and the first-round impacts of the changes to indirect taxes on cigarette prices. The downside deviation was partly offset by higher-than-expected food price inflation excluding the first-round impacts of indirect tax changes (see Table II.2).

Factors lying partly or completely outside the purview of the CNB's monetary policy, most notably external economic activity, inflation and interest rates and oil prices, acted towards higher-than-forecasted inflation in the period under review (see Table II.3).

According to the current view, the monetary policy settings in the key period were slightly tighter than forecasted. Consistent with the January 2006 forecast was a gradual rise in interest rates and a stable exchange rate outlook. Monetary policy interest rates were left unchanged in the key period and domestic nominal and real interest rates were lower than in the January forecast. The interest rate component of the real monetary conditions was slightly easier than forecasted, despite higher foreign interest rates. By contrast, the nominal exchange rate of the koruna deviated significantly in the anti-inflationary direction, hence the exchange rate component of monetary conditions was tighter.

When assessing the fulfilment of the inflation forecast, one needs to take into account changes in the CNB's view of the workings of the economy. The important changes made between January 2006 and the present include an extension of the core prediction model to include the effect of real wages on inflation, a related change in the description of the formation of inflation expectations and a partly related shift in the view of the equilibrium paths of the real exchange rate, real interest rates and the non-accelerating inflation level of output. The way of capturing economic developments in the Czech Republic's main trading partners was also changed. Other things being equal, these changes would together have led to slightly lower paths for the inflation forecast and implied interest rates.

Chart II.7
Actual inflation in 2007 Q2 was significantly lower than the January 2006 forecast
(annual percentage changes)

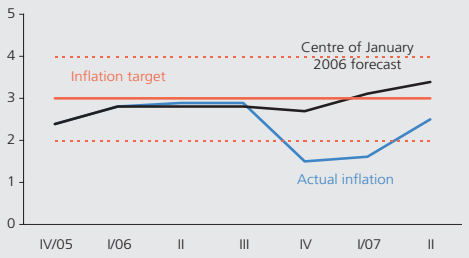


Table II.2
The main source of the deviation of actual inflation from the forecast was lower-than-expected adjusted inflation excluding fuels
(annual percentage changes; contributions in percentage points)

	October 2005 forecast	2007 Q2 outturn	Contribution to total difference a)
CONSUMER PRICES	3.4	2.5	-0.9
Breakdown into contributions:			
regulated prices	3.8	4.3	-0.1 c)
first-round impacts of changes to indirect taxes	0.6	0.4	-0.2
food prices b)	2.2	3.4	0.3
fuel prices b)	-1.6	-2.9	-0.1
adjusted inflation excl. fuels b)	2.7	0.9	-0.8

a) owing to rounding, the sum of the contributions need not be equal to the total difference
b) excluding the first-round impacts of changes to indirect taxes
c) the negative contribution of regulated prices despite the higher-than-expected regulated price inflation is due to a change in weights in the consumer basket as from January 2007

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

		I/06	II/06	III/06	IV/06	I/07	II/07
GDP in Germany a)	p	1.4	1.3	1.4	1.9	1.7	1.4
	o	2.3	2.3	2.7	3.7	3.3	-
GDP in euro area a), d)	o	2.5	2.5	2.7	3.5	3.1	-
CPI in Germany b)	p	2.5	2.0	1.4	1.2	1.2	1.5
	o	2.0	2.0	1.6	1.3	1.8	1.9
CPI in euro area b), d)	o	2.0	2.0	1.7	1.5	1.8	-
1Y EURIBOR	p	2.8	2.9	3.0	3.0	3.1	3.1
(percentages)	o	3.0	3.3	3.6	3.9	4.1	4.4
USD/EUR exchange rate	p	1.19	1.20	1.21	1.24	1.25	1.26
(levels)	o	1.20	1.26	1.27	1.29	1.31	1.35
Oil prices - Ural c)	p	52.8	51.0	50.0	49.5	49.5	49.5
	o	57.6	65.0	65.4	56.5	52.8	58.4
Oil prices - Brent c), e)	o	62.0	69.8	70.2	59.6	58.1	68.7

p - prediction, o - outturn

a) at constant prices; annual percentage changes; seasonally adjusted
b) annual percentage changes
c) USD/barrel
d) effective indicator; no comparison with the prediction is given, as the indicator was not tracked in the January 2006 forecast
e) no comparison with the prediction is given, as the indicator was not tracked in the January 2006 forecast

Any revisions made to economic indicators since the forecast was drawn up also have an effect on the fulfilment of the forecast. The new consumer basket introduced in January 2007, which decreased the weight of items and sub-aggregates whose prices have long been rising faster and, by contrast, increased the weight of items whose prices have long been rising more slowly, contributed significantly to the inflation forecast error observed in 2007 Q2. A large increase in the 2004 and 2005 GDP growth estimates made via revisions to the national accounts in March 2006 and June 2007 generated an increase in the estimated rate of growth of the potential, non-accelerating inflation level of output and led to an only slight upward revision to the output gap.

Based on the CNB's current knowledge of the workings of the Czech economy and its current knowledge of actual economic developments, the developments since the January 2006 forecast was drawn up can be summed up in the following way. The inflation pressures from the real economy have been positive and gradually rising since 2006 H2. Nevertheless, adjusted inflation excluding fuels was low over the entire period, as the appreciation of the koruna exchange rate had a strong anti-inflationary effect until the end of 2006 (see Table II.4). Headline inflation was initially close to the point inflation target, but subsequently fell below it as a result of several anti-inflationary factors.

An assessment of the risks associated with this forecast by the board members is also of importance for the Bank Board's decision on monetary policy rates. At its meetings between October 2005 and June 2006 (see the relevant minutes) the Bank Board assessed the risks of the forecasts drawn up in the key period as being roughly balanced or on the downside, owing to the greater-than-expected appreciation of the exchange rate. The monetary policy decisions of the CNB Bank Board remained approximately in line with the forecasts. With the benefit of hindsight, one can assess the interest rates in the key period as having been higher than necessary to fulfil the inflation target in 2007 Q2, subject to the application of the ex ante escape clauses to the first-round impacts of changes to indirect taxes.

Table II.4

Real economic growth was higher than forecasted, while the koruna-euro exchange rate was stronger than expected

		I/06	II/06	III/06	IV/06	I/07	II/07
3M PRIBOR	p	2.2	2.3	2.5	2.8	2.8	3.0
(percentages)	o	2.1	2.1	2.4	2.6	2.6	2.8
CZK/EUR exchange rate	p	29.0	29.0	29.0	29.0	29.0	28.9
(levels)	o	28.6	28.4	28.3	28.0	28.0	28.3
Real GDP	p	4.2	3.8	3.8	3.8	4.1	4.3
(annual perc. changes)	o	6.6	6.5	6.3	6.1	6.1	-
Inflation pressures	p a)	-0.3	-0.4	-0.3	-0.3	-0.1	0.0
from the real economy	o b)	-0.2	-0.1	0.1	0.3	0.5	0.7

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

Chart III.1
The dollar-euro exchange rate continued to depreciate in 2007 Q2

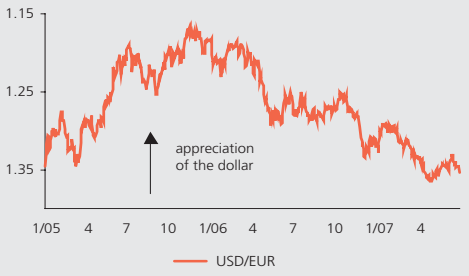


Chart III.2
The price of Brent crude oil neared USD 73 a barrel in the last week of June
(USD/barrel)

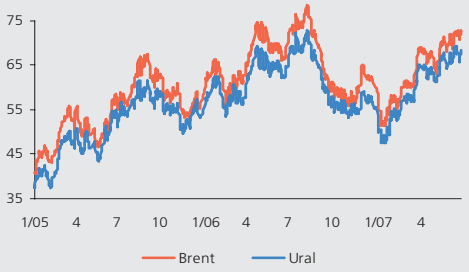


Chart III.3
In the euro area, economic growth eased in 2007 Q1, while inflation remained below 2%
(annual percentage changes)

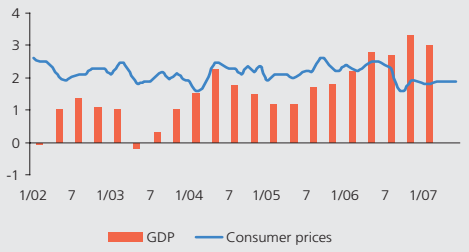
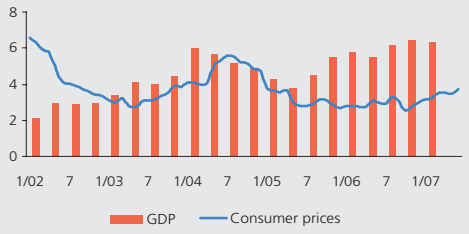


Chart III.4
GDP growth slowed somewhat in the 12 new EU Member States in 2007 Q1
(annual percentage changes)



III.1 THE EXTERNAL ENVIRONMENT

In 2007 Q1, economic growth in the Unites States slowed markedly and the lead of euro area growth over that in the USA increased. The dollar depreciated against the euro for the sixth consecutive quarter in 2007 Q2, approaching USD 1.37/EUR at the end of April (see Chart III.1). The price of Brent crude oil fluctuated between USD 63.0 and USD 72.8 a barrel in this period, the average level being 18.3% higher than in Q1 (see Chart III.2).

The US economy grew by 1.9% year on year in 2007 Q1, i.e. 1.2 percentage points less than in the previous quarter. An annual decline in fixed investment and an export slowdown hindered the growth. Household consumption, whose rate of growth remained almost unchanged, accounted for most of the GDP growth. Despite the lower economic growth the unemployment rate did not rise in Q2, remaining at the level of the previous two quarters (4.5%) and even showing a year-on-year decline of 0.1 percentage point.

At 2.7% in May, annual consumer price inflation in the USA deviated only slightly from the figures recorded in the previous two months. However, annual industrial producer price inflation rose to 3.9%, i.e. 0.7 percentage point higher than in the previous month. This was due mainly to renewed double-digit annual growth in fuel prices. The external imbalance of the United States narrowed somewhat in Q1. The current account deficit was USD 193 billion, displaying a slight year-on-year fall. The ratio of the current account to GDP decreased to -5.7%. In 2007 Q2, the Fed left its key rate at 5.25%. According to the FOMC members, the slightly higher core inflation indicates a risk that inflation will not be as subdued as previously expected.

Annual GDP growth in the euro area was 3.0% in Q1, due mainly to the favourable course of the German economy (see Chart III.3). Compared to the previous quarter, the growth slowed by 0.3 percentage point, mainly because of slackening household consumption growth and export growth. An upswing in fixed investment growth acted in the opposite direction. The solid growth of the economy – continuing for the fourth consecutive quarter – was positively reflected in the unemployment rate, which fell to 7.0% in May, 0.8 percentage point lower than in the same period a year earlier.

In June, annual consumer price inflation in the euro area remained at 1.9% for the fourth consecutive month. This is 0.6 percentage point lower than in the same month a year earlier. While modest energy price inflation dampened consumer inflation, food prices acted towards an increase. The favourable evolution of energy prices primarily affected producer prices, whose annual growth has eased as the year has progressed. Producer prices rose by only 2.3% in May (a year-on-year decrease of 3.7 percentage points). The current account deficit fell by EUR 13 billion year on year in Q1 and the current account ended almost balanced at EUR -1.4 billion, or -0.1% of GDP in Q1. At the beginning of June, the ECB raised its key rate for the second time this year, by 0.25 percentage point to 4.0%. According to the ECB, all the inflation risks indicate higher growth in prices. It still describes the current level of rates as easy.

Economic growth in Germany was relatively high in 2007 Q1 (3.3%). However, it fell by 0.4 percentage point compared to the previous quarter. The slowdown in GDP growth was fostered by a decline in household consumption, due to previous stocking up connected with expectations of a VAT increase. However, the fall in private consumption was largely offset by a big increase in fixed investment, primarily in the expansion of production capacities. The solid condition of the German economy was also evident from a further modest fall in the unemployment rate to 6.1% in May, the ninth consecutive monthly decrease. Consumer prices

increased by 2.0% in June, the same as in the previous three months. The higher price level reflected, among other things, the increased VAT rate.

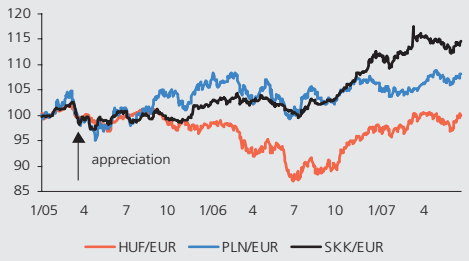
The countries of the Central European region continued to enjoy rapid economic growth overall in Q1, recording double the rate seen in the euro area countries. The fastest GDP growth was recorded by Slovakia and the slowest by Hungary.

Economic growth in Hungary reached 2.7% in Q1, down by 0.6 percentage point from the previous quarter. It remained the lowest in the region. The slowdown in GDP growth was due chiefly to a year-on-year decline in household consumption. Continuing fast growth in exports and an increase in inventories had the opposite effect. The unemployment rate in June remained at the previous month's level (7.7%), but recorded a modest year-on-year increase. Annual consumer price inflation in June was virtually unchanged from the previous two months (8.5%). As in previous months it was significantly affected by high deregulation-related growth in energy prices. The external imbalance narrowed in Q1 as a result of a substantial year-on-year decline in the current account deficit as a percentage of GDP, to 4.5%. At the end of June, after eight months of no change, the Hungarian central bank lowered its key interest rate by 0.25 percentage point to 7.75%. According to the bank, inflation had peaked, thus allowing monetary policy to be eased.

GDP growth in Poland was 7.4% in Q1, up by 0.8 percentage point on the previous quarter. This was partly the result of a further rise in household consumption growth, but was mainly due to an upswing in fixed investment. The unemployment rate fell by 3.7 percentage points year on year in May, in line with the improving economic performance. Nevertheless, it remained high (at 10.5% in May). Consumer price inflation rose to 2.6% in June. This was due chiefly to rises in energy and food prices. The ratio of the current account deficit to GDP rose slightly year on year in Q1, reaching 2.7%. In Q2, the Polish central bank's Monetary Policy Committee raised its key rate to 4.50% (in two steps of 0.25 percentage point, first in April and again in June). This was due primarily to a rise in unit wage costs and also to a risk of excessive demand ensuing from easier fiscal policy.

The rapid economic growth in Slovakia continued into 2007 Q1, reaching 9.0%. Compared to the previous quarter, it slowed by 0.6 percentage point. As in the previous quarter it was mainly a result of robust export growth. Household consumption and fixed investment also displayed buoyant growth. The high economic growth generated a further reduction in the unemployment rate, which fell to 10.8% in May (down by 2.8 percentage points year on year). Despite the strong domestic demand, annual consumer price inflation slackened in May and June, to 1.5%. This fall was due to prices of food and health services. Annual industrial producer price inflation slowed to 1.3% in May owing to fuel and metal price developments. The ratio of the current account deficit to GDP decreased by 5.4 percentage points year on year in Q1, to 0.9%. At the end of April, the NBS lowered its key rate by 0.25 percentage point for the second time this year, to 4.25%. The easing of monetary policy was aided in particular by the favourable inflation trend.

Chart III.5
Among the currencies of the Central European region, the Slovak koruna showed the strongest year-on-year appreciation in 2007 Q2
(average for January 2005 = 100)



III.2 THE MONETARY CONDITIONS

According to the CNB's calculations, the settings of the real monetary conditions in 2007 Q2 can be characterised as roughly neutral. The interest rate component was assessed as being slightly tight, whereas the exchange rate component was slightly easy.[9] The evolution of the two components of the monetary conditions in 2007 Q2 is described in more detail below.

III.2.1 Interest rates

Interest rates rose fairly significantly in 2007 Q2. The CNB raised its key interest rates by 0.25 percentage point. With effect from 1 June 2007, the 2W repo rate is 2.75%, the Lombard rate 3.75% and the discount rate 1.75%. This move had been expected by almost all financial market participants. Nervousness on the money market ahead of the CNB Bank Board's May meeting led to increased volatility at the shortest maturities and could be seen in banks' behaviour in repo tenders. Banks accumulated excess liquidity so that they could deposit the maximum liquidity with the CNB immediately after the expected repo rate increase. As a result, the shortest maturities temporarily fell well below the original repo rate.

Interest rates remained almost unchanged immediately after the announcement of the monetary policy tightening, but in the days that followed they continued rising moderately at all maturities. In addition to domestic factors (the accumulating inflation risks, the continuing growth of the Czech economy, the weakening koruna, a further expected rise in the CNB's key rates), interest rates were affected by the situation on foreign markets. Concerns about a global rise in rates negatively affected investors' view of newly developing economies; on these markets national currencies subsequently weakened and interest rates increased.

Money market rates rose by 0.3-0.5 percentage point overall in 2007 Q2. At 0.7–0.9 percentage point, the rise in rates with longer maturities was even higher. PRIBOR spot quotations and FRA forward quotations at the end of June 2007 indicated that financial market participants expected a further monetary policy tightening to occur at the CNB Bank Board's July meeting.

The PRIBOR yield curve gradually shifted to a higher yield level during 2007 Q2, rising at a higher rate at its longer end. Its slope thus became more positive. The spread between the 1Y PRIBOR and 2W PRIBOR was 0.60 percentage point in June. The IRS yield curve also moved upwards, doing so almost evenly over the entire length of the curve. The slope of the curve remained positive. In June, the average 5Y-1Y spread was 0.73 percentage point and the 10Y-1Y spread 1.05 percentage points.

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 ECB raised its refinancing operations rate by 0.25 percentage point to 4.00% during Q2, while the Fed left its key O/N rate at 5.25%. Market interest rates rose fastest on the domestic money market, hence the negative interest rate differentials vis-à-vis euro and dollar rates both narrowed somewhat.

CHART III.6
The CNB raised its key interest rates
(percentages)

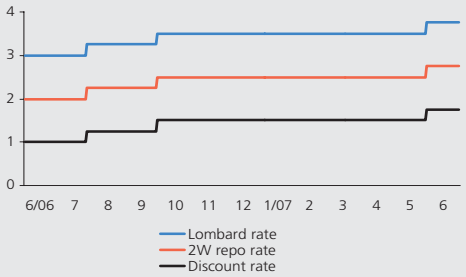


CHART III.7
Market interest rates rose in Q2
(percentages)

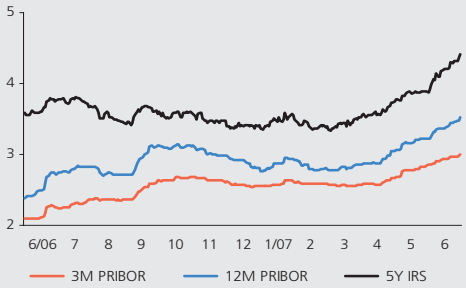
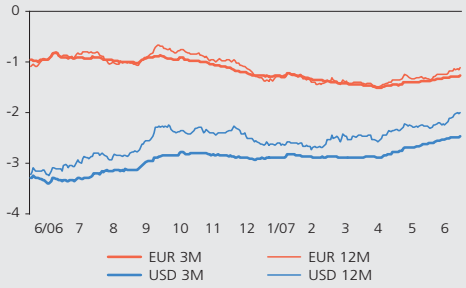


CHART III.8
Interest rate differentials vis-à-vis the euro and the dollar narrowed slightly
(percentage points)

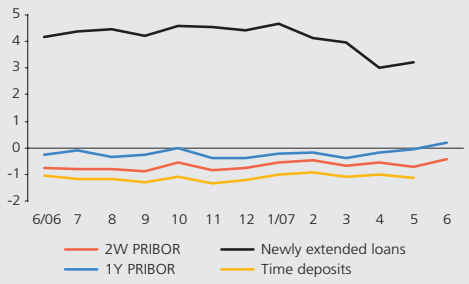


9 However, the current effect of monetary policy on economic activity and inflation also depends on the settings of the monetary conditions in previous quarters. The accumulated effect of the monetary conditions is assessed as being easy. This accumulated easy monetary policy setting in turn co-determines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

Ten auctions were held on the primary government bond market, with original maturities of 3Y–15Y and a total volume of CZK 58.9 billion. Most auctions met with sufficient interest, but some were negatively affected by the current market situation. The bonds that were not underwritten were purchased by the Czech Ministry of Finance into its portfolio. Fitch Ratings affirmed the Czech Republic's Foreign Currency Issuer Default Rating at "A", and its Local Currency Issuer Default Rating also remained unchanged at "A+". Despite a stable outlook, the agency warned against worsening fiscal developments.

Nominal interest rates on new loans were 6.0% and rates on new time deposits 2.0% in May. Real interest rates[10] are affected not only by the level of nominal rates, but also by movements in inflation expectations. Expected consumer price indices have long been higher than expected industrial producer price indices, but the two indicators were almost level during 2007 Q2. Real rates on new loans were 3.2% in May, while real rates on time deposits were -1.1%.

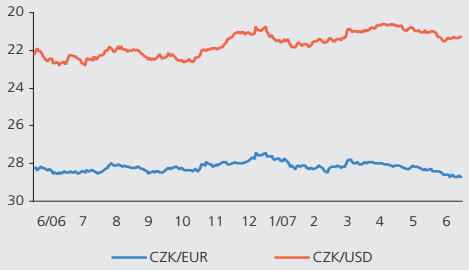
CHART III.9
Ex ante real interest rates on new loans decreased
(percentages)



III.2.2 The exchange rate

The average exchange rate of the koruna against the euro in 2007 Q2 was CZK 28.3/EUR, which represents a year-on-year appreciation of 0.4%. However, in quarter-on-quarter terms it weakened by 0.8%. The modest appreciation trend seen last year thus turned around. The koruna weakened appreciably during Q2, losing roughly 80 hellers. This weakening was due primarily to investors' interest in selling korunas in connection with the opening of "carry trades", during which borrowed korunas were invested up to the level of interest-bearing foreign currency assets in relation to both the region and to other currencies. Another significant factor was the sale of korunas connected with dividend payments to non-residents. Negative sentiment about the Central European region, caused by growing yields on US bonds and the strengthening of the dollar, also played a significant role, causing all the currencies of the region to weaken in the second half of May and at the beginning of June (see Chart III.10).

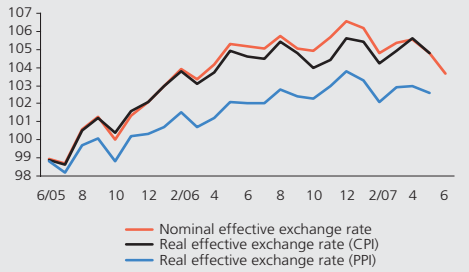
CHART III.10
The koruna depreciated against the euro in 2007 Q2



In 2007 Q2, the average exchange rate of the koruna against the dollar was CZK 21.0/USD, which represents a year-on-year appreciation of 7.2%. During the quarter, however, the exchange rate did not move in any single direction. In April and the second half of June the koruna appreciated slightly against the dollar, but a depreciation tendency prevailed in the remainder of the quarter. Overall, the koruna weakened by 35 hellers. The April appreciation of the koruna against the dollar was generated by less favourable macroeconomic data from the USA, intensifying trade disputes between the USA and China, and bad news from the subprime mortgage sector. The subsequent depreciation of the koruna was due chiefly to more favourable data from the USA and growth in yields on US government bonds.

The nominal effective exchange rate of the koruna appreciated again in 2007 Q1 (by 2.0%), but in Q2 it displayed a slight weakening of 0.2% (see Chart III.11). The year-on-year depreciation was fostered by a more marked weakening of the koruna against the Slovak koruna and Polish zloty. It was partly offset by an appreciation of the koruna against the euro and the dollar. The real effective exchange rate continued to appreciate year on year during Q2 due to faster growth in consumer and producer prices at home than abroad. In April–May the CPI-deflated real effective exchange rate firmed by 0.9% year on year. The rate of appreciation of the PPI-deflated real effective exchange rate was slightly higher (1.1% in April–May).

CHART III.11
The nominal effective exchange rate depreciated slightly year on year in 2007 Q2
(year 2005 = 100)



10 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 analysts each month.

III.3 THE BALANCE OF PAYMENTS

III.3.1 The current account

Table III.1
The current account surplus decreased slightly in 2007 Q1 mainly as result of a deterioration of the income balance
(CZK billions)

	I/04	I/05	I/06	I/07
A. CURRENT ACCOUNT	-13.1	24.4	17.6	13.4
Trade balance	1.3	28.4	31.0	42.2
Balance of services	4.9	9.3	7.2	5.3
Income balance	-18.9	-24.2	-20.5	-30.7
Current transfers	-0.4	11.0	-0.1	-3.4
B. CAPITAL ACCOUNT	0.3	1.2	2.4	2.6
C. FINANCIAL ACCOUNT	2.6	-15.3	-10.4	-14.5
Direct investment	27.2	27.5	13.0	26.3
Portfolio investment	23.4	-22.9	-8.1	-19.6
Financial derivatives	-0.3	1.1	-1.6	4.0
Other investment	-47.7	-21.1	-13.7	-25.1
D. ERRORS AND OMISSIONS	17.0	-7.1	-9.0	-0.7
E. CHANGE IN RESERVES (- = increase)	-6.9	-3.2	-0.7	-0.8

Chart III.12
The annual moving total of the trade surplus increased in 2007 Q1
(CZK billions)

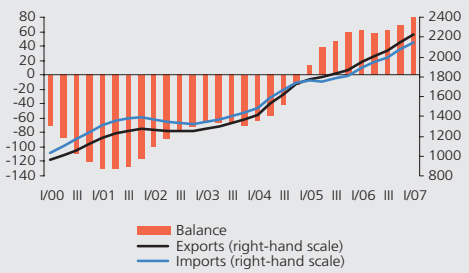
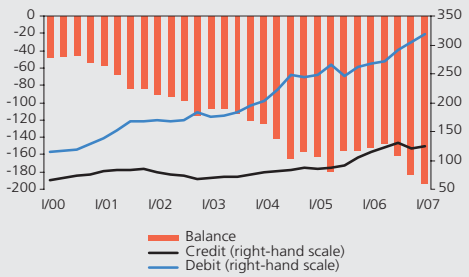


Chart III.13
The annual moving total of the income deficit increased in 2007 Q1
(CZK billions)



In 2007 Q1, the current account ended in a surplus of CZK 13.4 billion (see Table III.1), or 1.6% of GDP. In year-on-year terms, however, this represented a moderate decrease. Although the trade balance improved more significantly, it only partly offset the deterioration in the other three balances. The widening of the income balance deficit was particularly significant.

The trade surplus[11] reached CZK 42.2 billion in 2007 Q1, recording a year-on-year increase of more than CZK 11 billion. The positive effects of price developments, buoyant external demand, FDI inflows and the relocation of production to the Czech Republic were moderated by strong aggregate domestic demand growth and appreciation of the koruna against the euro (see Chart III.12). The annual improvement in the trade surplus was due exclusively to favourable price developments. The positive year-on-year change in the terms of trade was 3.7% in Q1. The price effect was roughly 50% offset by an unfavourable trend in real terms. The growth in the trade surplus continued into Q2, with a year-on-year increase of CZK 10 billion recorded for April and May.

As regards the commodity structure, the trade balance showed very mixed trends in 2007 Q1. The increase in the overall surplus was aided chiefly by favourable developments in machinery and transport equipment. A noticeable improvement was also recorded for the deficit on mineral fuels and the surplus on non-energy crude materials. Imports of oil and natural gas fell year on year in terms of both value and physical volume. By contrast, manufactured goods classified by material and chemicals recorded significant deteriorations. From the geographical perspective, the trade balance improvement was again due primarily to an increase in the trade surplus with the EU. Improvements were recorded particularly for trade with Slovakia and Germany. As regards non-EU countries, trade with Russia improved significantly. By contrast, trade with China recorded a considerable deterioration. It is with these two countries that the Czech Republic has the highest deficits.

The balance of services ended 2007 Q1 in a surplus of CZK 5.3 billion, which, however, represented a year-on-year decrease of CZK 2.0 billion. The decrease in the total surplus was due to a widening of the other services deficit as a result of a sharper annual decline in credits under computer services and a simultaneous rise in debits under technical services. The decline in the total balance was reduced by moderate growth in the surpluses on transport and travel.

The income deficit reached CZK 30.7 billion, representing a year-on-year deterioration of CZK 10.2 billion (see Chart III.13). The largest and fastest-growing component of the income balance was estimated reinvested FDI earnings. The direct investment income deficit thus widened (to CZK 28.8 billion) in year-on-year comparison. At the same time, the deficit on compensation of employees widened as well, owing to faster growth in expenditure on foreigners working in the Czech Republic. The rise in the income deficit was counteracted by moderate growth in the surpluses on income on portfolio investment and other investment (thanks to

11 The value of total goods imports recorded in the current account is calculated using the FOB methodology, where goods imports represent only the value of goods at the frontier of the exporting country and foreign trade costs are reported as a debit in the balance of services. By contrast, the analysis of the commodity and geographical structure of the trade balance published by the CZSO is based on goods imports under the CIF methodology, where goods imports represent the value of goods inclusive of foreign trade costs at the frontier of the Czech Republic.

faster growth in receipts representing income on the CNB's international reserves and interest income of commercial banks on deposits abroad).

Current transfers recorded a deficit of CZK 3.4 billion, deteriorating by CZK 3.3 billion year on year due to a sharp increase in debits. The determining factor for the current transfers deficit was a private transfers deficit of CZK 9.6 billion. By contrast, the balance of government transfers ended in a surplus. The balance of transfers between the Czech Republic and the EU budget was CZK +3.2 billion, representing a slight annual increase.

III.3.2 The capital account

The capital account ended 2007 Q1 in a surplus of CZK 2.6 billion, virtually unchanged compared to a year earlier. Its main component was government revenues from EU funds (CZK 2.7 billion), which increased slightly in year-on-year terms.

III.3.3 The financial account

In 2007 Q1, the financial account showed a deficit of CZK 14.5 billion, or 1.8% of GDP, representing a slight year-on-year increase. The widening of the deficit was due to an increase in net outflows of portfolio investment as a result of a loss of non-residents' interest in domestic securities, and to a simultaneous rise in the deficit on other investment owing to a change in flows (allocation) of short-term assets of commercial banks. The increase in the overall deficit was counteracted by growth in the direct investment surplus.

Direct investment recorded a surplus of CZK 26.3 billion, representing a year-on-year increase of CZK 13.3 billion. The FDI inflow into the Czech Republic doubled year on year, to CZK 30.3 billion. Its largest component was reinvested earnings (CZK 28.4 billion). Investment in equity capital was half this figure (CZK 14 billion). The moderation of the overall FDI inflow was due to developments under other capital, with loans from foreign parent companies being repaid. With regard to industries, the foreign capital inflow was channelled primarily into real estate and trade. By territory, the biggest individual investor countries were the Netherlands, Cyprus and Korea (see Chart III.14). Czech direct investment abroad increased modestly year on year, reaching CZK 4.0 billion. The capital outflow went chiefly into real estate and the chemical industry. Geographically, it went mainly to EU countries, particularly Bulgaria and Slovakia.

The net outflow of portfolio investment in 2007 Q1 was CZK 19.6 billion, compared to CZK 8.1 billion in the same period of 2006. Amid broadly unchanged purchases of foreign securities by residents, the annual widening of the deficit was due to a loss of non-residents' interest in domestic securities. The outflow of capital was CZK 17.3 billion and was linked almost exclusively with an increase in holdings of foreign shares by domestic non-bank institutions. This reflected the favourable economic developments abroad and more limited domestic investment opportunities due to the relatively narrow range of attractive securities on offer. Holdings of equity and debt securities by non-residents declined by CZK 2.4 billion as a result of sales. A significant change in year-on-year bond flows was due mainly to an issue of government bonds in the same period a year earlier (see Chart III.15). A net inflow of financial derivatives transactions generated a CZK 4.0 billion decrease in the financial account deficit.

Other investment recorded a net capital outflow of CZK 25.1 billion (compared to CZK 13.7 billion in the same period of 2006). The widening of the total deficit was

Chart III.14
Firms registered in Cyprus were the largest foreign investors in equity capital in the Czech Republic in 2007 Q1

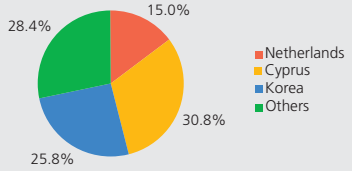


Chart III.15
Portfolio investment recorded a net outflow in 2007 Q1
(CZK billions)

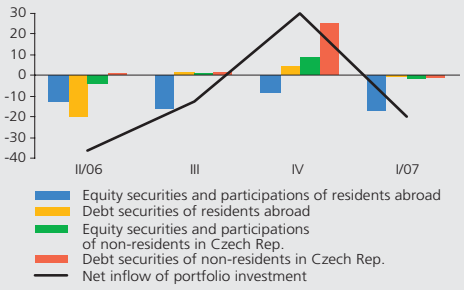
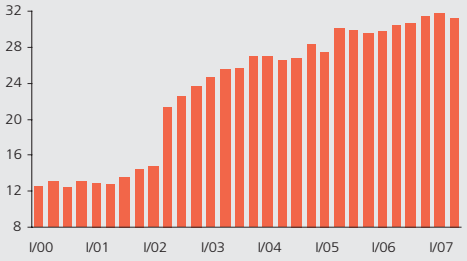


Chart III.16
The CNB's international reserves decreased slightly in dollar terms in 2007 Q2
(USD billions)



due mainly to an increase in the net outflow of capital through commercial banks (to CZK 19.4 billion). This was caused by a rise in short-term deposits abroad, representing a sizeable year-on-year change in flows. The corporate sector, the government sector and the CNB also contributed to the net outflow of other investment, albeit to a lesser extent. The net capital outflow of the corporate sector moderated to CZK 3.1 billion year on year. In particular, it was affected by an increase in short-term export credits. On the assets side, a government sector capital flows deficit of CZK 1.4 billion reflected an increase in the Czech Republic's contributions to international institutions.

The CNB's international reserves decreased by CZK 3.9 billion to CZK 663.2 billion in 2007 Q2. They also declined moderately in dollar terms, falling by USD 0.5 billion to USD 31.2 billion in the same period (see Chart III.16).

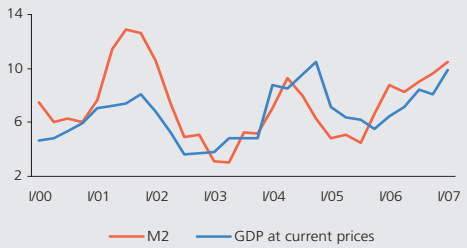
III.4 MONETARY DEVELOPMENTS

The money supply recorded its highest growth rates in five years in May 2007. The main contributor to the money supply growth was short-term relatively liquid money. The stronger increase in M2 reflected the low interest rates, which, together with the cyclical position of the economy, resulted in buoyant growth in loans to corporations and households. A pick-up in loans for house purchase was accompanied by a rise in prices on the real estate market. The monetary developments indicate potential further slightly inflationary effects in the medium term.

III.4.1 Money

Annual M2 growth accelerated in 2007 Q1 and again in April and May, reaching 12.1% in May. The rise in M2 was due to the low interest rates and primarily reflected growth in loans to corporations and households and, to a lesser extent, growth in net external assets and net credit to the government (see Chart III.17). The high money supply growth was broadly in line with the rapid nominal GDP growth. Indicators of the appropriateness of the M2 growth (the monetary overhang, the nominal and real money gap) nonetheless suggest a moderate shift to stronger inflationary effects in the medium term. This year, the money supply has risen faster than the estimated equilibrium demand for money.

Chart III.17
The high money supply growth was broadly in line with nominal GDP growth
(annual percentage changes)



Turning to the structure of M2, the rate of growth of quasi money continued to rise (see Table III.2). However, M1 remained the biggest contributor to money supply growth. Within M1, currency in circulation accelerated in line with the buoyant growth in household consumption. The higher growth in quasi money was due to short-term deposits with an agreed maturity of up to two years or redeemable at notice of up to three months. By contrast, the demand for long-term deposits with an agreed maturity of over two years or redeemable at notice of over three months and for repo operations was very low. The spreads between rates with an agreed maturity and rates on overnight deposits have been flat this year. Thus, the growth in demand for money continued to be concentrated in short-term liquid deposits, which, given the low interest rates, are being used to finance stronger economic activity.

Table III.2
The rate of growth of quasi money increased
(quarterly averages and end-of-month stocks; annual percentage changes)

	IV/06	I/07	4/07	5/07	Share in M2, % 5/07
M1	15.2	14.4	15.1	15.3	57.9
Currency in circulation	11.4	12.0	12.3	13.4	13.4
Overnight deposits	16.4	15.2	15.9	15.9	44.5
M2-M1 (quasi money)	2.8	5.7	7.0	8.0	42.1
Deposits with agreed maturity	-2.5	2.3	4.5	5.2	30.0
Deposits redeemable at notice	19.5	18.7	18.9	18.9	11.7
Repurchase agreements	8.0	-40.3	-53.4	-38.8	0.4
M2	9.6	10.5	11.4	12.1	100.0

The rising money supply growth was due chiefly to household deposits, in line with the high growth in household incomes and consumer demand. The contribution of deposits of non-monetary financial institutions also increased. Household deposits accounted for 53% of the M2 growth, while deposits of non-financial corporations and non-monetary financial institutions accounted for 26% and 21% respectively.

III.4.2 Credit

Lending growth has accelerated this year, and reached 21% in May (see Table III.3). The relatively high growth in loans reflected the low interest rates and buoyant economic growth. The average interest rate on new loans was 6% in May. The ratio of total loans to GDP increased by 0.7 percentage point to 40.6% in Q1, remaining flat at 23.3% for corporations and rising to 17.3% for households. However, it remained much lower than in the euro area.

Loans to non-financial corporations increased by 18.9% year on year in May, but their rate of growth has slowed this year. Short-term and long-term loans grew less strongly, although their rate of growth remained high and was consistent with the high economic growth. This was visible for loans to the branches of trade, sales and repair and manufacturing. By contrast, higher growth was again recorded for real estate financing loans (granted to developers) and loans to the financial intermediation industry (financial leasing). The interest rate on new loans to non-financial corporations edged up to 4.4%. Loans granted to non-financial corporations by non-bank institutions (factoring and forfaiting companies[12]) rose by 22.5% in 2007 Q1, but their volume was less significant than that of MFI loans.

As regards the structure of financing of large non-financial corporations with 250 employees or more[13] (see Box 2 *Financing of non-financial corporations* in the April 2007 Inflation Report), the ratios of external funds and internal funds to total liabilities remained balanced in Q1. In year-on-year terms, external funds rose by 7.5% and internal funds by 4.1%. Domestic loans grew faster than foreign loans owing to a persisting negative interest rate differential.

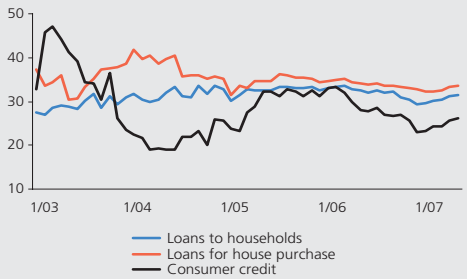
Annual growth in loans to households accelerated in 2007, reaching 31.4% in May. Loans for house purchase and consumer credit both contributed to the stronger growth in loans to households (see Chart III.18), reflecting, among other things, the low level of interest rates. The interest rate on new loans for house purchase remained at 4.5%. The spreads between interest rates with longer (over one year) and shorter fixations have declined since mid-2006. This has led to an increase in the volume of new loans for house purchase with longer fixations (see Box 1 *The relationship between interest rates and the structure of new loans for house purchase*). The expansion of loans for house purchase is also in line with the evolution of the property market, the faster growth in gross disposable income (which has boosted the availability of loans) and the wider supply of MFI loans. The stronger consumer credit growth reflected the relatively high consumer demand of households accompanied by the rising inflation, as well as a decline in the interest rate on new loans of 0.3 percentage point to 11.8% since the beginning of 2007. In Q1, households also obtained more loans to finance consumption from non-bank institutions, especially hire-purchase companies. These loans rose by 12.7% year on year.

The ratio of total household debt (with banks and non-banks) to gross disposable income rose by 1.4 percentage points to 42% in 2007 Q1. For bank loans, the increase was 1.2 percentage points to around 35%. The average debt burden per

Table III.3
Growth in loans to households accelerated
(quarterly averages and end-of-month stocks; annual percentage changes)

	IV/06	I/07	4/07	5/07	Share in total loans, % 5/07
Non-financial corporations	19.4	19.2	19.1	18.9	48.7
Loans up to 1 year	12.5	10.5	10.8	9.1	17.8
Loans over 1 year and up to 5 years	15.1	19.2	19.9	24.9	12.0
Loans over 5 years	30.8	29.0	27.5	25.6	18.9
Households	30.3	30.1	31.2	31.4	43.0
Consumer credit	25.1	23.9	25.7	26.2	8.6
Loans for house purchase	33.1	32.4	33.4	33.6	29.9
Other loans	23.3	27.7	27.8	27.3	4.5
Non-monetary financial institutions	-5.9	-7.4	-7.2	-7.1	8.3
Total loans	20.6	20.6	21.0	21.0	100.0

Chart III.18
Loans for house purchase and consumer credit both contributed to the higher rate of growth of loans to households
(annual percentage changes)



12 Factoring is the purchase of short-term receivables. It is suitable for companies with high operating capital needs and can act as a substitute for short-term bank loans. Forfaiting is the purchase of medium and long-term receivables.

13 The structure of financing of large non-financial corporations is based on the economic results of non-financial corporations as published by the CZSO. As from 2007, these results are published for corporations with 250 employees or more (compared to the former reporting population of corporations with 100 employees or more).

capita, as measured by the ratio of repayments of principal and interest to income, rose slightly to 4.5%. Interest costs paid by households reached 1.7% of gross disposable income and remained lower than interest income (2.8%).

BOX 1
The relationship between interest rates and the structure of new loans for house purchase

Nominal interest rates on new loans for house purchase rose following the increases in monetary policy interest rates in October 2005. However, interest rates with various fixation periods have shown mixed trends since 2006 H2, and this has affected the structure of new loans for house purchase. In line with the evolution of the yield curve, rates fixed for shorter periods (up to one year)[14] have increased, while rates with longer fixations have tended to decline. The spreads between long-term and short-term interest rates have thus decreased (see Chart 1).

Although loans with longer interest rate fixations account for the majority of total loans, their share declined between 2004[15] and mid-2006 (see Chart 2). This trend reversed in mid-2006, with the share of longer interest rate fixations rising to 65% and that of shorter interest rate fixations falling to 35% (this reversal was particularly strong for loans with interest rate fixations of over one and up to five years and with interest rate fixations of up to one year). This reflected a decline in spreads between long-term and short-term rates. The rise in the share of loans with long-term rates may also reflect sufficient MFI funds raised through mortgage bond issues, efforts of MFIs to increase the availability of loans by extending their maturities, and stronger competition between MFIs on this segment of the loan market.

Overall, the above information indicates that households' decisions regarding interest rate fixation periods on new loans are governed by initial expenses. The current rise in the proportion of loans with long-term interest rates suggests that households have started to show a greater preference for loans with longer interest rate fixations. The rise in the share of loans with interest rate fixations of over one year and up to five years (especially fixations of three years) can be regarded as positive as regards hedging by households against future interest rate increases. Nevertheless, if interest rates rise across all maturities in the long term, there could be adverse effects on households' balance sheets, especially in the case of low-income households.

Similar movements in the structure of interest rates and the shares of new loans have also been visible since the end of 2005 in the euro area, where the spreads between long-term and short-term rates have almost disappeared. The share of loans with longer interest rate fixations in the euro area has increased, reaching 56% in May.

Chart 1 (Box)
Spreads between interest rates on loans for house purchase with long and short fixation periods decreased
(new business; spreads against rate fixed for up to one year in percentage points)

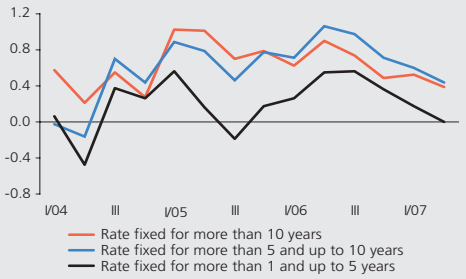
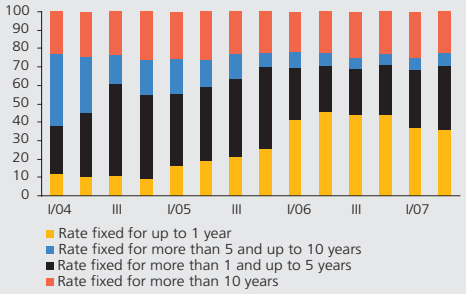


Chart 2 (Box)
The proportion of loans for house purchase with long fixation periods has been rising since mid-2006
(new business, share in total)



14 Interest rates with a fixation period of up to one year also include floating interest rates.
15 Data on the structure of new loans for house purchase and the interest rates on such loans are available from 2004 onwards.

III.5 DEMAND AND OUTPUT

Rapid economic growth – in excess of 6% – continued in 2007 Q1. According to the CZSO's preliminary estimate, annual real GDP growth was 6.1%, the same as in the previous quarter and slightly higher than expected. According to the CNB's calculations, the economy slightly exceeded the potential, non-accelerating inflation level of output for the sixth consecutive quarter.

Turning to the structure of annual real GDP growth, the changes seen in 2006 strengthening the influence of domestic demand continued to be visible (see Chart III.20). By 2007 Q1, GDP growth was being driven exclusively by domestic demand. The growth was supported mainly by consumption expenditure of households and change in inventories, which reached extraordinary levels compared to previous quarters. Unlike in previous quarters, growth in gross fixed capital formation, which had been one of the main sources of economic growth in 2006, decreased significantly. This may have been just a short-term deviation, as no indication of a turnaround in investment demand was recorded. Only the contribution of the real foreign trade balance to output growth was negative in 2007 Q1, although real exports grew rapidly, testifying to the continuing strong export performance of the Czech economy. However, import growth was faster and was affected to a large extent by the buoyant domestic demand.

On the supply side of the economy, the continuing economic growth was reflected in gross value added in most branches of industry and services. Services were the largest contributor to output growth in Q1, although the share of industry was also significant. Within industry, the largest volumes of value added were generated in manufacturing, which had seen major structural changes in the previous period. Value added growth picked up in construction thanks to the good weather. By contrast, gross value added in agriculture continued to fall year on year.

III.5.1 Domestic demand

Annual growth in total final consumption expenditure increased modestly in 2007 Q1, reaching 4.7%. As in the previous quarter, the increase was due chiefly to fast growing household final consumption expenditure (6.7%), as government expenditure rose only slightly in Q1 and the contribution of expenditure by non-profit institutions was insignificant. The largest increase (13.4%) was recorded by gross capital formation, whose contribution to domestic demand growth was even higher than that of household consumption. However, its rapid growth was largely due a higher change in inventories year on year.

Consumer demand

Household consumption growth continued its long-term upward trend in 2007 Q1. Household final consumption expenditure increased by 6.7% year on year, the highest growth rate recorded since 2003 Q4. This was in line with the results of a CZSO business survey indicating that consumer confidence reached a historical high in 2007 Q1. Although the consumer confidence index declined slightly in Q2, it still recorded relatively high levels, suggesting that households' higher propensity to consume might continue in the period ahead.

The further pick-up in household consumption expenditure growth in 2007 Q1 was due to a sizeable increase of 2.9 percentage points in the annual growth rate of nominal gross disposable income compared to the previous quarter (to 8.2%, or 7.1% in real terms). This rapid growth was mainly due to wages and salaries – the largest component of household disposable income – which rose by 8.4% year on

Chart III.19
Economic growth was just above the 6% level in 2007 Q1
(annual percentage changes)

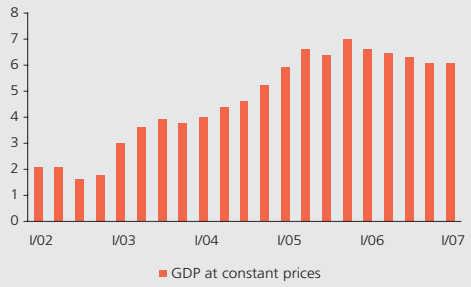


Chart III.20
The buoyant GDP growth in 2007 Q1 was driven by domestic demand
(contributions in percentage points; annual percentage changes)

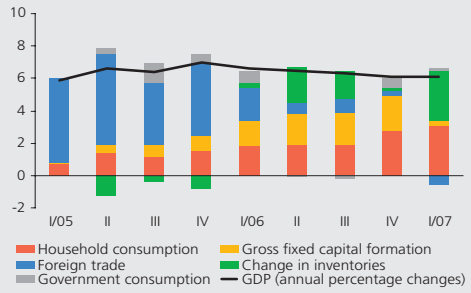


Table III.4
Household consumption and gross capital formation contributed the most to domestic demand growth
(annual percentage changes; CZK billions)

	I/06	II/06	III/06	IV/06	I/07
GROSS DOMESTIC PRODUCT	6.6	6.5	6.3	6.1	6.1
A. FINAL CONSUMPTION EXPENDITURE	3.8	2.7	2.4	4.6	4.7
household consumption	3.8	4.1	4.0	5.6	6.7
government consumption	3.8	-0.5	-1.1	2.4	0.4
non-profit institutions serving households	7.6	4.3	4.1	2.0	6.6
B. GROSS CAPITAL FORMATION a)	7.5	15.0	13.8	10.2	13.4
gross fixed capital formation	6.8	7.5	7.8	8.1	1.5
C. NET EXPORTS OF GOODS AND SERVICES (balance in CZK billions, constant 2000 prices)	14.2	1.0	-7.3	-19.7	4.9
imports of goods and services	19.6	12.7	11.8	17.1	16.5
exports of goods and services	21.2	13.0	12.7	17.1	14.6

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

Chart III.21
Household consumption growth rose sharply amid fast rising incomes
(annual percentage changes)

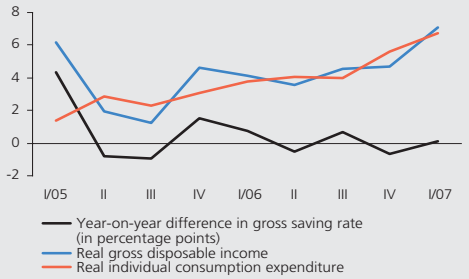


Chart III.22
Consumer confidence was high in 2007 Q1
(2005 average = 100)

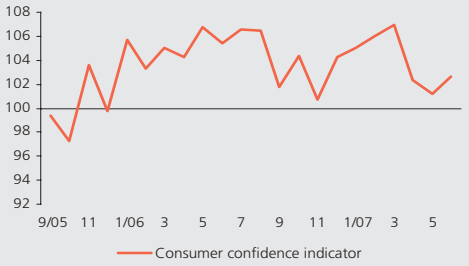


Chart III.23
The sharp downturn in fixed investment growth was due mostly to a fall in investment in machinery and equipment
(annual changes in CZK billions)

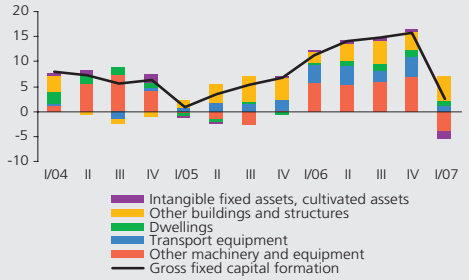
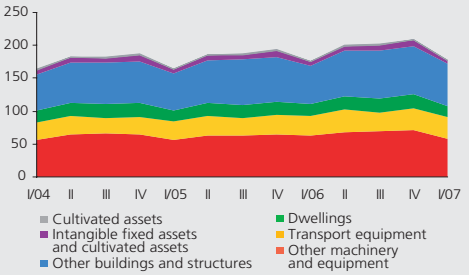


Chart III.24
Investment in machinery and equipment was still one of the main components of total investment
(CZK billions; constant 2000 prices)



year for the reasons specified in detail in section III.6 *The labour market*. The contribution of operating surplus and mixed income was also important; its annual growth rate increased significantly to 9.1%. Although growth in social benefits[16] picked up only slightly, their annual increase was also large (7%). Households also partly financed their growing consumption expenditure from credit, the growth of which picked up gradually in Q1 (for details see section III.4 *Monetary developments*).

In 2007 Q1, as in previous quarters, households' continuing high propensity to consume was due to several factors, in particular strong consumer confidence, which was affected by the persisting favourable economic situation and growing incomes. The favourable conditions for borrowing also persisted, supported in the past by the easy interest rate component of the monetary conditions and the overall decline in the prices of durable consumer goods. According to the CZSO, households channelled their increased consumption expenditure in Q1 into household equipment and routine maintenance of the house, purchase and operation of motor vehicles, and clothing, footwear and audio-visual equipment.

Investment demand

Annual growth in gross fixed capital formation in 2007 Q1 recorded an unexpectedly large fall and did not thus fulfil the CNB's April forecast of steadily increasing fixed capital investment (see Chart III.23). Having reached around 8% in the previous quarter, it amounted to just 1.5% in Q1. The interruption of the growth trend was due mainly to investment in machinery and equipment, where the previous rapid growth was replaced by a 6.6% decline in Q1. Slower growth or declines compared to the previous quarter were also recorded in the other investment categories; only the growth rate of investment in other buildings and structures increased, reaching its highest values since the start of 2005.

The structure of investment and some other indicators suggested that all the monitored sectors contributed to the overall slowdown in investment growth in 2007 Q1.[17] A 3.7% year-on-year decline in investment expenditure of the government sector at current prices indicated a real decline in investment in this sector. In the non-financial sector, which accounts for roughly two-thirds of total investment, the rate of growth of investment is estimated to have slackened to values close to zero. However, the structure of investment by kind shows that only investment in structures increased in this sector. A sizeable pick-up in imports of investment goods and a large increase in inventories in Q1 suggested at the same time that the larger decline in machinery and equipment investment in Q1 might have been only temporary. The hypothesis of a short-term fluctuation in investment demand in Q1 is also supported by the favourable results of the CZSO's survey of producer confidence in industry, the prospects for investment activity for the period under review[18] and the still favourable conditions for investment financing.

Investment in dwellings, which primarily concerns the household sector, also recorded a slower annual rise in Q1 than in the previous quarter (4.5%). Given high annual growth in the number and approximate value of building permits for residential buildings in 2007 Q1, the persisting good conditions for provision of

16 i.e. social benefits other than social transfers in kind.

17 The CZSO publishes data on the structure of investment by kind on a quarterly basis only, so the analysis of total investment by economic sector is based on partial indicators.

18 According to these surveys, the respondents in industry expected increase in investments by 6% in the period October/November 2006 – March/April 2007.

mortgages and other factors stimulating demand for new dwellings,[19] housing investment can probably be expected to increase again in the near future.

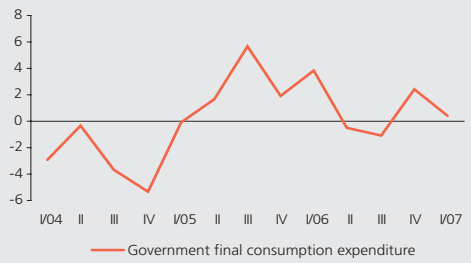
Government demand

According to the CZSO's latest estimate, real growth in general government expenditure on final consumption was only moderate in 2007 Q1, amounting to 0.4% (4% at current prices). This means that the impact of government consumption on aggregate demand in the Czech economy was neutral in this period. A more detailed analysis of government demand can be derived from the development of the state budget – the largest component of government sector finances – in the period under review. Although growth in total state budget revenues lagged behind growth in total expenditure in Q1, the state budget ended in a surplus of CZK 11.3 billion.[20] However, this surplus was CZK 4.4 billion lower than in the same period a year earlier.

The causes of the lower state budget surplus in 2007 Q1 can be seen mainly on the revenue side, where revenues from indirect and direct taxes grew at only a modest pace and fell short of the budgeted values.[21] Moreover, non-tax and capital revenues recorded a sharp annual fall (16.6%), owing to almost 50% lower drawings on reserve funds than in the same period a year earlier.

The largest increase on the expenditure side was recorded for social security benefits (up by 33.4%), mainly because of changes to "social" laws passed before the June 2006 elections.[22] Non-investment transfers to local budgets also recorded a significant increase, owing to a change in the financing of social services and other benefits. However, this increase was almost entirely offset by a reduction in expenditure under General Treasury Administration, where such expenditure had been recorded last year. Declining debt service costs counteracted the rise in total expenditure. However, the aforementioned expenditure items do not directly affect government demand. Public wage expenditure, which does affect government demand, increased by 7.4% in 2007 Q1.

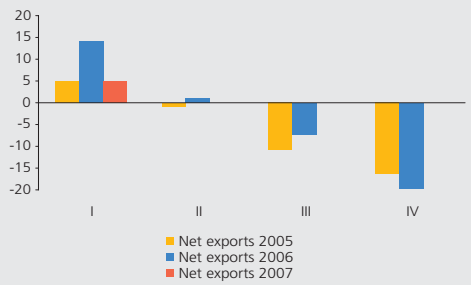
CHART III.25
Government final consumption expenditure increased only slightly in 2007 Q1
(annual percentage changes)



III.5.2 Net external demand

Although the buoyant, double-digit growth in foreign trade turnover continued into 2007 Q1, net exports of goods and services[23] recorded a year-on-year decrease of CZK 9.4 billion. The main reason for the continuing annual decline in net exports, observed since the previous quarter, was high growth in aggregate demand, connected with rapid growth in total imports. Annual growth in imports reached 16.5% in Q1, only slightly lower than in the previous quarter. Growth in exports remained strong (14.6%), but, unlike in previous quarters, rose noticeably more slowly than imports (see Chart III.27). As a result, import growth overtook export growth in Q1 for the first time in a long time and the contribution of foreign trade to GDP growth was negative.

CHART III.26
Net exports deteriorated year on year in 2007 Q1
(CZK billions; constant 2000 prices)



19 In particular, the then expected increase in VAT on housing as from 1 January 2008 and demographic developments.

20 State budget revenues and budget expenditure rose by 2.6% and 4.8% respectively. These and the other figures in this section are given at current prices.

21 Collection of VAT increased by 4.3%, consumer taxes by 4.4%, corporate income taxes by 1.9% and personal income taxes by 4.9% year on year.

22 This mainly concerned an increase in family and birth allowances as from 1 January 2007.

23 At constant 2000 prices.

Chart III.27
Imports rose faster than exports for the first time in a long time
(annual percentage changes)

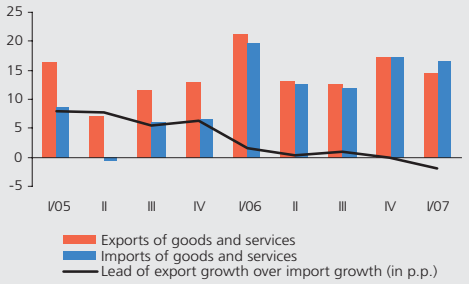


Chart III.28
Services were the biggest contributor to the high economic growth in 2007 Q1; the contribution of manufacturing decreased
(contributions in percentage points)

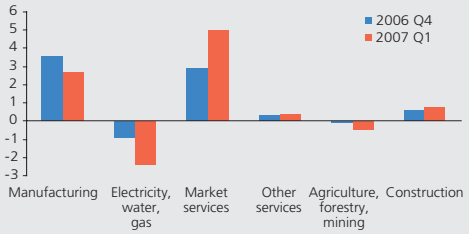
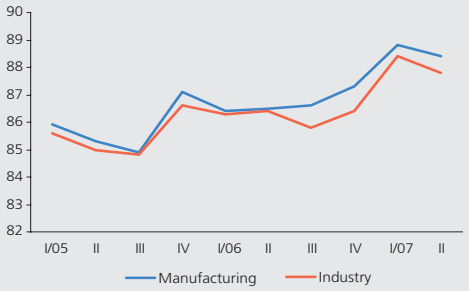


Chart III.29
The rapid economic growth was achieved amid high production capacity utilisation
(2005 average = 100)



The annual deterioration in net exports was due mainly to the trade balance, which declined after ten quarters of growth.[24] The cause of this change can be seen primarily in persisting strong growth in goods imports, which reached a sizeable 17.9% in Q1. In particular, investment imports reached exceptionally high levels for the second consecutive quarter, exceeding the annual growth rate of total imports almost twofold. A continuing expansion of international production collaborations, resulting in a rising import intensity of production, also helped to keep imports strong. Although the decline in the overall trade deficit was counteracted by rapidly growing goods exports (16.7%), the latter did not fully offset the strong import growth. As mentioned in previous Inflation Reports, the continuing high export performance of the Czech economy was mainly due to the launching of export-oriented production facilities supported by foreign direct investment[25] and increased external demand.

III.5.3 Output

On the supply side of the economy, annual growth in gross value added at basic prices remained high in 2007 Q1, at more than 6%. More than two-thirds of this was due to an increase in aggregate productivity, as in the previous quarter. The contribution of increased employment was thus less than one-third. High production capacity utilisation[26] in most branches of industry (see Chart III.29) and other indicators on the supply side (particularly in the labour market) suggested at the same time that the economy was growing in an environment where actual output was slightly above the potential, non-accelerating inflation level of output. These findings confirmed the results of the CNB's estimates regarding the position of the Czech economy in the business cycle.

The continuing strong economic growth was significantly aided by ongoing structural changes within sectors and industries, supported primarily by foreign capital. The sectoral breakdown of economic growth changed partially in Q1, as for the first time in a long time the services sector became the largest contributor to the rapid annual growth in gross value added. By contrast, the contribution of manufacturing, which had dominated in 2006, declined to around 40%. The slackening growth in value added was even more pronounced in industry as a whole, owing to an exceptionally sharp annual decline in value added in the electricity, gas and water supply industry. The other sectors saw no major changes in trends. Value added continued to decline in agriculture, but increased in construction owing to the good winter weather.

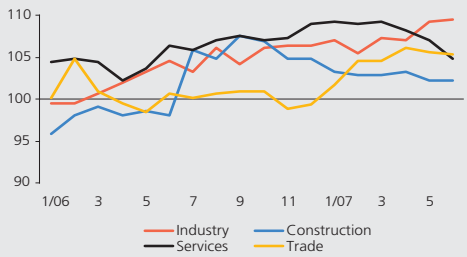
Growth in value added increased in services, thanks mainly to trade, where value added growth recorded a marked year-on-year increase of 12.5 percentage points to 21% in Q1 compared to the previous quarter. This extraordinary development was largely associated with a further increase in household consumption expenditure to the highest level since the end of 2003. Under these circumstances, the contribution of trade to the overall annual rise in gross value added noticeably approached that of manufacturing.[27] Market services in real

24 The deterioration in net exports in 2007 Q1 was also due to a widening services deficit; this factor was, however, less significant.
25 Particularly in the car and electrical engineering industries.
26 In 2007 Q2, production capacity utilisation exceeded 89% in 12 of the 23 sectors monitored.
27 These two branches accounted for almost 80% of the total growth in value added at basic prices in 2007 Q1.

estate, business services and transport services also made major contributions to value added growth in Q1.

By contrast, gross value added growth in manufacturing slowed in Q1, although it remained high (9.4% year on year). According to a survey of value added in individual branches,[28] most industries were profiting from the continuing economic boom. Nevertheless, there were still marked differences in the rates of growth of value added[29] across individual branches. According to these statistics, the value added growth was the most driven by four branches – manufacture of basic metals and fabricated metal products, manufacture of transport equipment, manufacture and repair of machinery and equipment, and manufacture of other non-metallic mineral products. These branches accounted for almost 55% of the volume of gross value added in manufacturing. The main factors underlying this result were structural changes supported by foreign capital, which affected output growth at new production and assembly facilities, and significant shifts in demand in some branches. According to the latest survey of confidence in industry and the expected flow of orders, manufacturing output can be expected to continue rising rapidly in near future.

Chart III.30
The business confidence indicator increased in June to its highest level since June 2000
(2005 average = 100)



III.5.4 Economic results of non-financial corporations[30]

According to the available data and the CNB's calculations, the favourable trends in the main indicators of the performance of monitored non-financial corporations recorded in the previous two years continued into 2007 Q1. Annual growth in book value added remained particularly strong, reaching 10.2%.[31] According to the CNB's calculations, this result was achieved amid a 9.2% increase in output.

As in the previous quarter, corporations generated profit in an environment of weakening external cost pressures stemming from prices of oil and natural gas on world markets. Their import prices declined year on year, fostering a decrease in producers' costs. However, prices of domestic energy sources (electricity and coal) continued to rise apace, and prices of imported intermediate goods and metals also recorded growth. According to the CNB's calculation, this contrary trend in prices of important energy-producing and raw material inputs gave rise to only a very slight annual increase in the material-cost output ratio overall in 2007 Q1 (see Table III.6). In manufacturing alone, the share of manufacturing costs in output was even lower than in the same period a year earlier. By contrast, the personnel cost-output ratio in 2007 Q1 signalled gradual changes in the opposite direction, rising for the first time in a long time (see Table III.6). In manufacturing, however, the personnel cost-output ratio recorded an annual decline in Q1.

Overall, the material cost-output and personnel cost-output ratios in 2007 Q1 confirmed continuing changes in the structure of costs and the overall evolution of

Table III.5
The rapid growth in book value added continued into 2007 Q1
(CZK billions; annual percentage changes)

	Q1		Annual changes	
	2006	2007	CZK billions	%
Output excl. profit margin [a)]	1,025.6	1,119.6	94.0	9.2
Intermediate consumption	772.2	844.1	71.9	9.3
Sales, total	1,376.8	1,515.9	139.1	10.1
Personnel costs [a)]	152.6	169.7	17.1	11.2
Book value added	303.5	334.4	30.9	10.2

a) CNB calculation

Table III.6
The personnel cost-output ratio rose by more than the material cost-output ratio
(percentages; annual changes in percentage points)

	Q1		Change in p. p. against 2006 Q1
	2006	2007	
Personnel cost-output ratio [a)]	14.9	15.2	0.3
Material cost-output ratio [a)]	75.3	75.4	0.1
Ratio of personnel costs to value added [a)]	50.3	50.7	0.4
	CZK thousands per month		Annual perc. change
Book value added per employee	52.9	57.2	8.1

a) CNB calculation

28 According to data on gross value added in monitored large non-financial corporations with 50 employees or more.

29 At current prices.

30 With effect from 2007 Q1, the CZSO significantly changed the scope of the set of monitored non-financial corporations and also the scope of indicators of the economic performance of non-financial corporations. The survey now also covers corporations with 50 employees or more and corporations with 250 employees or more. The structure of the data provided has also changed significantly, with personnel costs, profit, depreciation, return on equity and other indicators no longer published. The assessment is based on a set of corporations with 50 employees or more and draws partly on calculations based on partial data published by the CZSO.

31 All figures in this section are given at current prices.

the costs of output. These changes were associated mainly with prices of important material inputs and the changing situation between supply and demand on the labour market at a time of buoyant economic growth (see section III.6 *The labour market*). However, the impacts of the aforementioned factors on costs – with related implications for producer prices – were mixed across individual industries and enterprises.

As in previous quarters, very significant volumes of book value added were generated in foreign-owned corporations in 2007 Q1. Their share in total book value added in the monitored set of non-financial enterprises rose to 53% in 2007 Q1, while the share of private domestic corporations declined to 36%. The data on value added in the newly monitored sets of non-financial enterprises also reveal that the biggest volumes of value added were generated in large enterprises.

III.6 THE LABOUR MARKET

In 2007 Q1, the labour market saw continuing growth in labour demand amid still buoyant economic growth. Ongoing structural changes in the economy and favourable domestic and external demand fostered rising employment, especially in industry and services. The increasing employment and the large number of vacancies generated a further decline in the unemployment rate, which was predominantly cyclical in nature. Despite this, the relatively high proportion of long-term unemployment persisted, reflecting a problem with the professional and skills structure of the unemployed. Growth in nominal unit wage costs picked up further overall, but was not across the board in nature.

CHART III.31
The continuing buoyant economic growth was accompanied by rising employment
(annual percentage changes; percentage points)

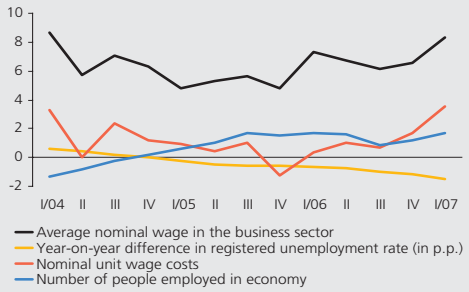
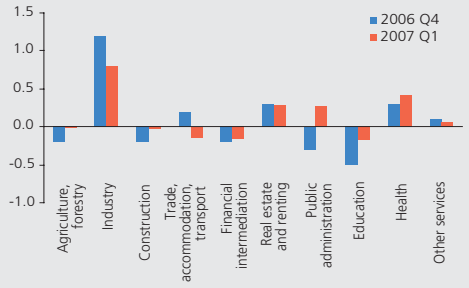


CHART III.32
Employment rose in industry and services
(contributions in percentage points; selected branches)



III.6.1 Employment and unemployment

The data on employment in 2007 Q1 confirmed a continuation of the upward trend observed with slight fluctuations since 2004. According to CZSO figures, employment growth picked up further in Q1 (to 1.7%) and total employment reached its highest level since mid-1998. The rise was mainly due to the sectors that are the main sources of economic growth – industry and services.

In Q1, the largest increase in the number of the employed was recorded in manufacturing (38,900 people, or 2.9%). As in previous quarters, the continuing growth in employment in this sector was linked with foreign direct investment, the development of related activities and generally favourable domestic and external demand. Within market services, the largest rises in employment were again recorded in renting and business activities (24,400 people year on year), in response to growing demand for various services at a time of buoyant economic growth. There was also a rise in the number of people employed in non-market services following an absolute decline in 2006, the size of which was higher than that in market services.[32] The growing demand for labour was also met from external sources. The annual increase in the number of foreign workers in Q1 was probably associated with the unusually good winter weather, which enabled construction work to go on unhindered.

32 Marked growth in employment was recorded in public administration, defence and compulsory social security (10,800 people). Employment growth was also high in health, veterinary and social work (18,500 people), which includes both market and non-market services.

However, growth in employment was not seen across the board in Q1. Strong competition and changes in demand in some branches conversely exerted strong downward pressures on the number of workers, a situation observed in numerous branches of industry and services.[33] Overall, however, there were no major changes in the employment structure. The most people were still working in the tertiary sector (56.3%). The share of the secondary sector remained relatively high (40.1%) compared to the EU-25 countries.

Continuing growth in labour demand was also indicated by the creation of vacancies. The number of vacancies – which are a potential source of employment growth or a decline in unemployment – rose rapidly in 2007 Q1 (see Chart III.33). The slope of the Beveridge curve meanwhile suggested that the growing labour demand was cyclical in nature in 2007 Q1 and Q2.

The pronounced rise in employment in 2007 Q1 was accompanied by fast declining unemployment (see Chart III.34). The registered unemployment rate fell annually by 1.5 percentage points to 7.3% in March. According to more detailed analyses, the cyclical component of registered unemployment declined.[34] This observation is supported by data on a higher number of placed applicants and a lower number of reported unemployed in 2007 Q1. The number of inactive persons,[35] representing a potential labour force reserve, also recorded a decline in Q1. According to the latest MLSA data, the registered unemployment rate continued to decline in 2007 Q2, reaching 6.5%.

However, the unemployment structure simultaneously indicated that the gradual improvement in the labour market situation for cyclical reasons had not yet led to a substantial narrowing of the skills and professional gaps between the supply of, and demand for, labour. Although the long-term unemployed fell significantly in number (by 48,400 year on year according to LFS figures), they still accounted for more than half of the unemployed (54.5%). The problem of high long-term unemployment persisted mainly among people with only basic education, who accounted for almost 70% of the total number of the long-term unemployed.

III.6.2 Wages and productivity

Annual growth of the average nominal wage in the national economy rose sharply in 2007 Q1 to 7.8%, the second-highest level since 2002 Q2. At 6.2%, real average wage growth was also fast. Wages were affected mainly by the persisting buoyant economic growth accompanied by the fast declining unemployment. The wage growth remained very mixed across sectors and industries, but inter-industry wage differentiation decreased compared to the previous quarter.

Chart III.33
High creation of vacancies fostered a fall in unemployment
(seasonally adjusted numbers in thousands)

Chart III.34
The decline in the number of unemployed people in 2007 Q1 was the largest since the start of the 1990s
(annual changes in thousands of persons)

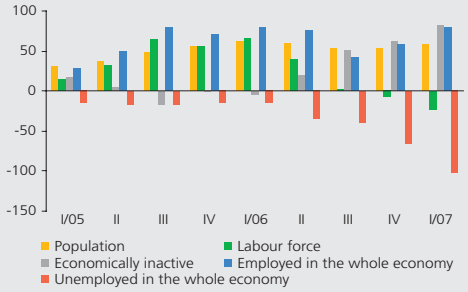


Chart III.35
The number of the long-term unemployed decreased in 2007 Q1, but the long-term unemployment rate remained high
(percentages; percentage points; source: LFS)

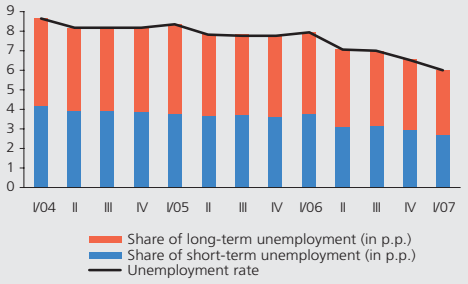


Table III.7
Average wages rose sharply in 2007 Q1
(annual percentage changes)

	I/06	II/06	III/06	IV/06	I/07
Average wage in monitored organisations					
nominal	7.0	6.6	5.9	6.1	7.8
real	4.1	3.6	2.9	4.5	6.2
Average wage in business sector					
nominal	7.3	6.7	6.1	6.6	8.3
real	4.4	3.7	3.1	5.0	6.7
Average wage in non-business sector					
nominal	5.9	5.9	5.4	4.4	6.1
real	3.0	2.9	2.4	2.9	4.5
Whole-economy labour productivity	5.2	4.9	4.3	4.3	4.1
Nominal unit wage costs	0.3	1.0	0.7	1.7	3.5

33 Year-on-year declines in the number of employed people were recorded in agriculture, trade, pre-primary and primary education, transport, electricity, gas and water supply, and financial intermediation.

34 The registered unemployment rate (MLSA) is based on the number of applicants available to start work immediately. The CNB also uses the total registered unemployment rate (calculated from MLSA data), which regards all job applicants as unemployed, enabling better monitoring of labour market flows. This unemployment rate is thus around 0.5 percentage points higher than the unemployment rate based on the number of available applicants. The general ILO (CZSO) unemployment rate fell to an eight-year low of 6.1% in 2007 Q1.

35 In this context, inactive persons are those who are not working and not actively seeking work, but who are interested in working.

Chart III.36
Average wage growth picked up pace in all monitored sectors
(annual percentage changes)

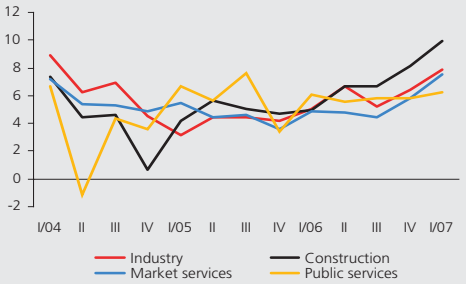


Chart III.37
Productivity growth slowed further, but remained relatively high
(annual percentage changes)

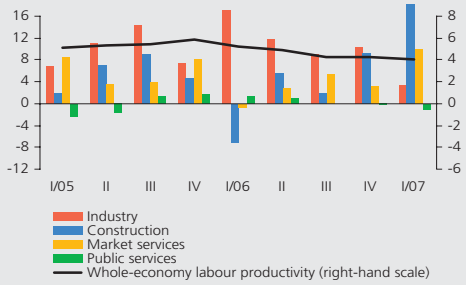
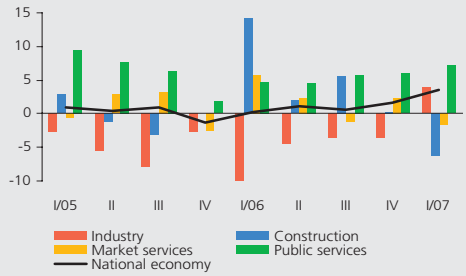


Chart III.38
Growth in nominal unit wage costs continued to edge up in 2007 Q1
(annual percentage changes)



The fast growth in average wages in 2007 Q1 was driven primarily by wages in the business sector, where the annual growth rate of the average wage reached a three-year high (8.3%). This was consistent with the position of the economy at a time of strong economic growth accompanied by decreasing unemployment. Corporations increased the remuneration of their employees amid rapid growth in productivity and rising profits in most industries. Another important factor affecting wage growth was the very mild winter this year, whereas the weather in the same period a year earlier had been very unfavourable. Work could thus go on without any major seasonal deviation, particularly in construction and related industries.

Annual average wage growth increased in all the monitored branches of the business sector. Average nominal wage growth in industry was 7.9%. In construction, where work continued unhindered in the winter, average nominal wages rose by 10%. A marked pick-up in wage growth was also recorded in market services, where average wages had been broadly flat until 2006 Q3 (see Chart III.36). Average wages also rose in the non-business sector (to 6.1%), but, as in 2006, their growth lagged behind that in the business sector. This was mainly because wages in this sector depend primarily on the capacities of the state budget and legislative measures of the government.

The most important factor as regards inflation, though, was whether the buoyant wage growth was accompanied by corresponding growth in productivity indicators. In 2007 Q1, a further slowdown in whole-economy productivity growth (to 4.1%), accompanied by faster average wage growth, resulted in a further upturn in annual nominal unit wage cost growth. Nominal unit wage costs indicate potential inflationary pressures arising in the wage area. Chart III.38 shows that in addition to public services, this trend was also due to industry, where nominal unit wage costs had declined in the previous three years. The renewed nominal unit wage cost growth in industry was, however, largely due to an extraordinary rise in the electricity, gas and water supply industry.[36] In manufacturing, which is the main component of industry, productivity continued to grow faster than average wages and nominal unit wage costs showed a year-on-year decline. However, their decline from the previous high levels has been gradually easing since 2006 Q2, and stood at a mere -0.6% in Q1. The rapid, double-digit productivity growth fostered a decline in nominal unit wage costs in market services and construction, which had recorded mostly growth in previous quarters of 2006.

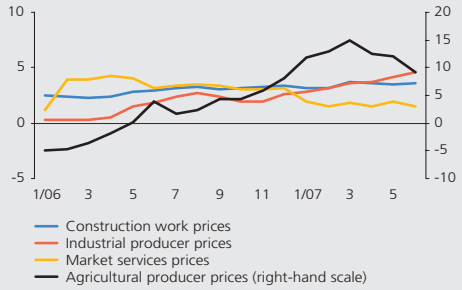
Overall, the gradual rise in nominal unit wage cost growth continued into 2007 Q1, although it was still generally subdued with regard to inflationary pressures and not across the board in nature. Except for public services, where nominal unit wage costs are showing a long-term upward trend and the scope for productivity gains is limited, nominal unit wage costs are not constantly rising in the other monitored industries. They are highly volatile and are influenced to some extent by seasonal or extraordinary effects. However, the gradual moderation of the decline in manufacturing can be regarded as a consequence of the changing situation between supply and demand on the labour market at a time of persisting strong economic growth.

36 Nominal unit wage costs here rose by 75.9% amid an annual decline in value added and productivity and an increase in wages. One of the likely reasons was lower electricity consumption last winter.

III.7 IMPORT PRICES AND PRODUCER PRICES

World prices of energy-producing materials fostered a further easing of the external cost pressures on domestic inflation in 2007 Q2. As in previous quarters, their impact on domestic prices was largely corrected by annual appreciation of the koruna-dollar exchange rate. At the same time, however, growth in prices of some other imported inputs, particularly metals, picked up pace and prices of some important domestic inputs grew quickly (electricity, solid fuels). This contrary trend in the prices of inputs fed through to producer costs. Industrial producer price inflation accelerated further overall in Q2, but this increase did not concern all branches of industry. Construction work price inflation was roughly at the end-Q1 level. Market services price inflation slowed. Annual agricultural producer price inflation moderated considerably, but remained high (see Chart III.39).

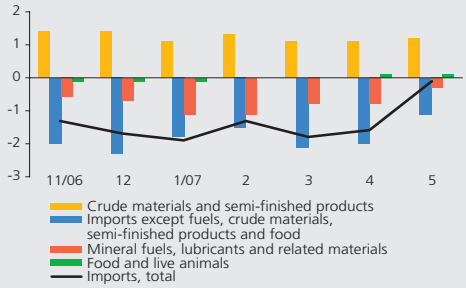
CHART III.39
Producer price inflation in industry rose in 2007 Q2
(annual percentage changes)



III.7.1 Import prices

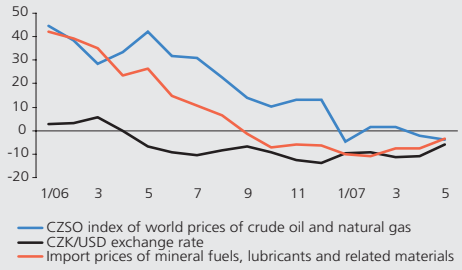
Given the high openness of the Czech economy, import prices are an important domestic inflation factor. Their long-running annual decline eased considerably in May, reaching only 0.1%. This was chiefly due to prices of "other imports"[37] and import prices of mineral fuels, as shown in Chart III.40.

CHART III.40
The year-on-year decline in import prices eased markedly in May
(annual percentage changes; contributions in percentage points))



In 2006 and in the first five months of this year, the trend in import prices of mineral fuels was determined by slowing growth in prices of energy-producing materials on world markets. As shown in Chart III.41, their annual growth has fluctuated at near-zero levels since the start of 2007. Oil prices started to decline in the same period. Natural gas prices, which follow oil prices with a lag, recorded an annual decline in May. The aforementioned trend in the prices of energy-producing materials and the still pronounced annual appreciation of the koruna-dollar exchange rate[38] resulted in a continuing annual decline in koruna import prices of mineral fuels, according to the latest figures for May. However, the decline moderated significantly compared to April, reaching 3.3% (see Table III.8).

CHART III.41
The anti-inflationary effect of world prices of energy-producing materials on import prices was bolstered by annual appreciation of the koruna-dollar exchange rate
(annual percentage changes)



By contrast, prices of other imported raw materials[39] continued to show an annual rise, owing to fast growing metal prices on world markets, picking up further to 7.6% according to the May figures. Although import prices of commodities with a higher degree of processing[40] usually exhibit lower volatility than import prices of raw materials, their annual decline moderated noticeably in May. Their structural trends were mixed, mainly due to the different levels of foreign inflation in the individual categories of imported commodities. While import prices in the categories of transport equipment and miscellaneous manufactured articles continued to show an annual decline (of 3% and 1.8% respectively), prices of manufactured goods classified chiefly by material continued to grow, reaching 4.5% in May. Growth in prices of imported oils and chemicals meanwhile edged up, and import prices of food also started to rise in March.

Prices in the two key categories of imported raw materials thus continued to show different trends in 2007 Q2. While the declining prices of imported energy-

37 Prices of imports excluding mineral fuels, raw materials, semi-manufactures and food.
38 The annual appreciation of the koruna-dollar exchange rate was 5.8% in June.
39 Excluding mineral fuels.
40 Primarily machinery and transport equipment, manufactured goods classified chiefly by material, miscellaneous manufactured articles and chemicals and related products.

Table. III.8
The contrary trend in the import prices of energy and other raw materials continued
(annual percentage changes)

	2/07	3/07	4/07	5/07
IMPORTS, TOTAL	-1.3	-1.8	-1.6	-0.1
of which:				
food and live animals	-0.7	0.5	1.8	1.5
beverages and tobacco	-3.8	-1.1	-2.1	-0.3
crude materials except fuels	3.6	3.7	3.2	7.6
mineral fuels and related products	-10.7	-7.6	-7.5	-3.3
animal and vegetable oils	9.9	9.3	10.2	13.9
chemicals and related products	2.7	1.5	1.8	3.1
manufactured goods classified by material	6.1	4.5	4.5	4.5
machinery and transport equipment	-3.7	-4.5	-4.3	-3.0
miscellaneous manufactured articles	-2.5	-3.7	-3.1	-1.8

Chart III.42
Industrial producer price inflation rose to its highest level since April 2005
(annual percentage changes; contributions in percentage points)

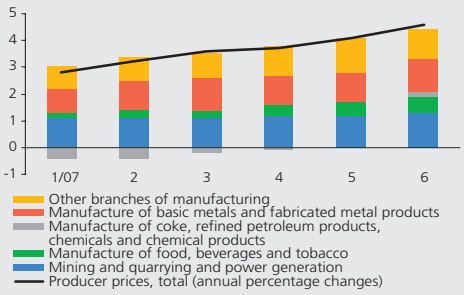
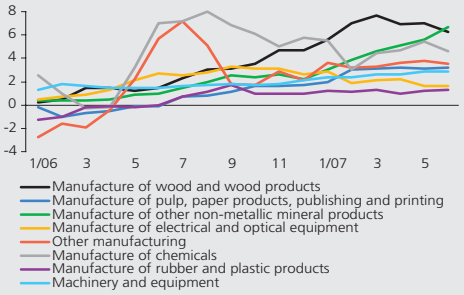


Chart III.43
At the end of 2007 Q2, prices were no longer falling in any branch of industry
(annual percentage changes; selected branches)



producing materials fostered a reduction in domestic producers' costs, the rising prices of other raw materials and manufactured goods (including intermediate goods) signalled a potential build-up of inflationary pressures among some producers, most notably in industry. The price developments in the other import categories were also mixed. This affected domestic producer prices, but prices of industrial products intended for the consumer market showed an annual decline.

III.7.2 Producer prices

Industrial producer prices

The gradual pick-up in industrial producer price inflation observed since October 2006 continued into 2007 Q2 (to 4.6% in June). This trend was mainly due to producer prices in mining and quarrying and power generation, manufacture of metals and other manufacturing industries,[41] as illustrated in Chart III.42.

Annual producer price inflation in the manufacture of basic metals and fabricated metal products amounted to 8.7% in June, up slightly on March. The continuing fast growth in prices of products in this industry was still due mainly to increased external demand. Prices in mining and quarrying, which consists mainly of coal mining, also rose substantially (8.6%). Although producer prices in the electricity, water and gas supply industry also grew very quickly in Q2, their growth moderated slightly compared to March (to 7.2% in June).

Prices continued rising in most[42] of the other branches of manufacturing, accounting for almost one-quarter of the price growth in industry. Overall, the contribution of the other branches of manufacturing to annual inflation in industry increased slightly in Q2.[43] The contribution of producer prices in the food industry also increased compared to March. This was evidently linked with agricultural producer price developments (see Chart II.4). The annual price increase in industry in June was also affected by the manufacture of coke and refined petroleum products. Nevertheless, the price increase was probably caused by prices in coke manufacture, as the koruna import prices of oil continued to decline year on year.

Prices thus continued to rise in all industrial branches in 2007 Q2. According to the CZSO's June figures, no branch of industry recorded an annual decline in prices. However, not all branches contributed to the further rise in overall annual industrial producer price inflation. Significant price growth or a sizeable upswing in prices was observed in branches where producers faced stronger cost pressures of both foreign and domestic origin and where the main input commodity is a major component of costs. At the same time, however, prices signalled a more pronounced effect from the growing demand in some branches (in particular manufacture of construction materials and energy sectors).

41 This includes manufacture of machinery and equipment, electrical and optical equipment, transport equipment, rubber and plastic products, other non-metallic mineral products, wood products, pulp, paper, textiles and textile products, leather products, chemical products and manufacturing products not elsewhere classified.

42 The exception was manufacture of transport equipment, where a long-running decline in prices switched to an annual stagnation in June.

43 This was due mainly to a sizeable increase in annual producer price inflation in the category of other non-metallic mineral products, to 6.7% in June. In particular, prices of bricks and tiles recorded a rise of 27.8%.

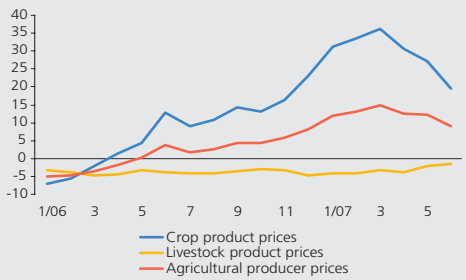
Agricultural producer prices

Agricultural producer prices continued rising very quickly in 2007 Q2, although their annual growth started slowing gradually in April from the high levels observed in the previous quarter (from 15% in March to 9.1% in June). This change in trend was due to slackening growth in crop prices, which was partly offset by a slowdown in the annual decline in livestock product prices.

Most of the major crop commodities contributed to the marked annual slowdown in crop price inflation from 36.2% in March to 19.4% in June. Prices of the previously fastest growing crop commodity – potatoes – switched from a sizeable increase of 115.8% in March to a slight decline in June (-1%). Price growth in the highest-weight category – cereals – was also slower in June, slackening by 3 percentage points compared to March, to 36.1%. Prices of vegetables recorded a sizeable annual decline in Q2. Overall, the downswing in crop product price inflation[44] in Q2 was mainly due to a gradual unwinding of the inflationary effects of the lower harvest in 2006.

Livestock product prices continued to show an annual fall, which has now been recorded for around one and a half years. In 2007 Q2, however, the decline moderated, reaching -1.4% in June. This was mainly due to a moderation of the annual appreciation of the koruna-euro exchange rate in the first half of this year.

CHART III.44
The slowdown in agricultural producer prices was due to prices of crop products
(annual percentage changes)

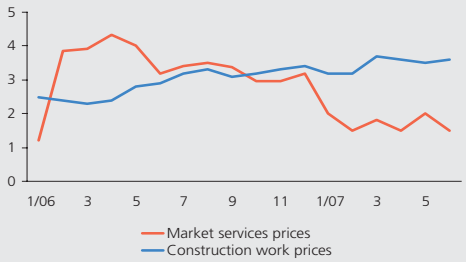


Other producer prices

Following a marked pick-up in March (to 3.7%), annual construction work price inflation remained higher throughout 2007 Q2 (3.6% in June; see Chart II.45). This appreciable change compared to the previous quarter is due mainly to persisting high demand for construction work. Annual growth in prices of materials and products consumed in the construction industry meanwhile recorded a sizeable increase (to 7.4% in June), reflecting not only high demand, but also some cost inputs (especially metals).

Following a marked decline in growth at the start of this year (to 1.8% in March), market services price inflation was volatile in Q2, reaching 1.5% in June. This was mainly due to the highest-weight category, business services,[45] where prices rose by 2.3% year on year in June. Fast growing prices in the categories of sewerage collection charges, freight transport and storage also contributed to the growth in market services prices in Q2. Conversely, prices of insurance services showed an annual decline throughout Q2.

CHART III.45
Construction work price inflation in 2007 Q2 stayed at the end-Q1 level
(annual percentage changes)



44 Excluding the volatile prices of fruit and vegetables.

45 Their constant weight in the index of market services in the business sector is 58.44%.

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 June 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 further towards higher economic growth and – in connection with that growth – towards higher interest rates. Expectations of foreign inflation have changed only slightly despite the higher expected economic growth and a significant inflationary shift in the expected prices of oil and petrol.

Table IV.1

Economic growth in the euro area will remain relatively high
(quarterly averages)

	III/07	IV/07	I/08	II/08	III/08	IV/08
Brent crude oil prices (USD/barrel)	69.7	71.0	71.9	72.4	72.5	72.4
ARA petrol prices (USD/t)	694.0	635.0	643.0	684.0	706.3	664.6
GDP in euro area a)	2.6	2.2	2.1	2.4	2.4	2.3
Producer prices in euro area a)	1.8	2.2	2.4	2.2	1.9	1.8
Consumer prices in euro area a)	1.9	2.0	1.9	1.8	1.7	1.7
USD/EUR exchange rate	1.35	1.35	1.35	1.34	1.33	1.33
1Y EURIBOR (in per cent)	4.5	4.6	4.7	4.7	4.7	4.7

a) effective indicator; annual percentage changes

The new reference scenario (see Table IV.1) assumes 1.9% growth in the effective indicator of consumer prices in the euro area this year. Compared to the April forecast this is a moderate upward shift, due mainly to a revision of German inflation as a result of stronger economic growth. Expected consumer price inflation for 2008 remains unchanged at 1.7%. This year's VAT increase 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 July forecast assumes that growth in the effective indicator of producer prices in the euro area will be just above 2% in both 2007 and 2008. Owing to the favourable developments in the euro area economies in 2007 Q1, analysts have again significantly revised their outlook for economic growth this year. Economic growth in the euro area in effective terms should reach 2.7% this year and slow to 2.3% next year. However, the expected effect of external demand on the domestic economy remains slightly anti-inflationary over the entire forecast horizon, albeit to a lesser extent than in the past.

The price of oil continued to rise in Q2, the growth rate significantly exceeding the market expectations at the time the April forecast was prepared. The new market outlook for oil prices has thus shifted upwards, with prices expected to rise further from an average of USD 68.7 a barrel in 2007 Q2 to more than USD 72 a barrel in 2008 Q2. Petrol prices on the ARA markets should progress similarly, rising as high as USD 700 a ton in summer 2008 with seasonal fluctuations.

The depreciation of the dollar against the euro continued into Q2. Owing to the recent developments, the June Consensus Forecasts again revised the expected future dollar-euro exchange rate towards a weaker dollar. The exchange rate of the dollar should be broadly stable around USD 1.35/EUR this year and strengthen slightly to USD 1.33/EUR at the end of next year. The implied one-year EURIBOR trajectory has shifted upwards owing to higher economic growth in the euro area countries. The average annual rate should be 4.4% this year and 4.7% in 2008.

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 July forecast uses an unchanged estimate of the public finance deficit in 2007 (3.5% of GDP), but a slightly lower one for 2008 (3.0% of GDP) in line with the Czech Republic's commitments to the EU. The fiscal forecast for 2008 newly

incorporates measures that can be implemented next year even if the fiscal reform as a whole is not approved. These measures fall within the exclusive competence of the government, ensue from the Czech Republic's harmonisation obligations to the EU (the introduction of environmental taxes) or enjoy relatively broad support across the political scene (the postponement of the date of effect of the Health Insurance Act to 1 January 2009). The forecast does not include the potential effects of the tax and social legislation proposed as part of the government's fiscal reform. It is not yet certain whether and in what final form the legislation will be approved by Parliament. In this respect, there is currently greater uncertainty than there was for the April forecast, which included an alternative scenario simulating the effects of the fiscal reform.

Owing to the deficit reduction, the CNB expects fiscal policy to have a dampening effect on demand next year. The fiscal impulse, which approximates the effect of fiscal policy on demand in the economy, will shift from being positive this year to slightly negative in 2008. It still holds true that no sizeable additional fiscal stimulus is expected from the inflow of money from EU funds at the forecast horizon.

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 values 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 prediction model.

Two changes were made to the CNB's quarterly prediction model as part of the July forecast. The parameters of the model equations for the import prices of food and energy had to be revised owing to a transition to a new weighting scheme for import price inflation and a revision of this time series. Furthermore, the term premium in the model equation for one-year interest rates was revised slightly upwards following an analysis of forecasting abilities.

Following a change in the outlook for foreign real interest rates, which has shifted upwards as a result of expectations of higher nominal rates and only slightly higher inflation, and in line with the rise in external potential growth, the path of the equilibrium real 1Y EURIBOR has been increased over the forecast horizon, to 2.0% at the end of 2008. The one-year domestic real equilibrium rate has also been slightly increased to just above 1%. At the forecast horizon, the estimated rate of equilibrium real appreciation remains unchanged between 3.0% and 3.5%, with a gradually declining tendency. Following the release of the GDP growth estimate in 2007 Q1 and the revision of the data for the last three years, the estimate of the current growth rate of the potential, non-accelerating inflation level of output has been raised slightly, to 5.8%. The rate of growth of the non-accelerating inflation level of output will decline gradually to 5.5% at the forecast horizon. Equilibrium real wages are rising somewhat slower than the non-inflation accelerating level of output at the forecast horizon, but their expected rate of growth has increased compared to the April forecast.

The model uses real marginal costs to proxy for inflation pressures from the real economy. These costs 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 for 2007 Q2 has shifted towards a more inflationary effect compared to the April forecast, owing to a more open

positive output gap. With inflation slightly higher than expected, the higher-than-expected domestic and foreign real GDP growth in Q1 and the related upward revision of estimated GDP growth in Q2 were almost fully reflected in a wider output gap. By contrast, faster-than-expected real wage growth resulting from unexpectedly high growth in nominal wages was mostly reflected in a revision of the rate of growth of the equilibrium real wage. Together with a revision of the real wage gap towards a more anti-inflationary effect in the past owing to faster growth in labour productivity (affected by the revision of GDP data), this means that the estimated real wage gap remained unchanged in Q2. Its current effect can thus be characterised as roughly neutral.

The inflationary pressures from the volume of production, approximated by the output gap, stem from the strong, more than 6% GDP growth, which is outpacing potential output growth. The negative output gap closed at the end of 2005 and has remained positive since then. Household consumption and gross capital formation are significant sources of growth. According to a CZSO estimate, fixed investment rose by just 1.5% year on year in Q1, but a large increase in inventories and an expansion of construction output and investment imports suggest that fixed investment will probably continue to grow rapidly in Q2.

The pressures from real wages had an opposite, anti-inflationary, effect in the past two years. However, the sharp decline in inflation at the turn of this year combined with the upswing in nominal wage growth generated a rise in real wages, which thus converged to their equilibrium level.

Consumer price inflation was above the April forecast in 2007 Q2. The largest deviations from the assumptions were recorded by fuel prices, which rose as a result of higher world prices of oil, and the impacts of changes to indirect taxes, as cigarettes with higher prices appeared on the market a month earlier than forecasted. Growth in regulated prices was also slightly higher. Food price inflation and adjusted inflation excluding fuels were broadly in line with the forecast.

The current settings of the real monetary conditions, which affect the future course of the business cycle, are assessed as being neutral to slightly easy overall. The exchange rate component is assessed as being slightly easy in 2007 Q2, due to the depreciation of the nominal exchange rate, while the interest rate component is slightly tight.

Chart IV.1
The real economy will have inflationary effects over the entire forecast horizon
(percentages)

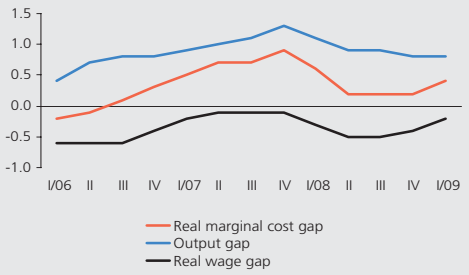
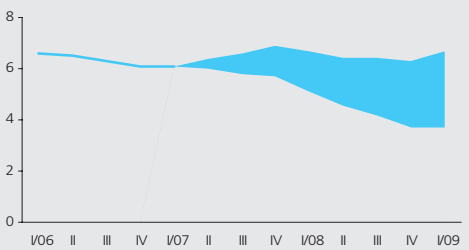


Chart IV.2
GDP growth will gradually slow
(annual percentage changes)



IV.3 THE MESSAGE OF THE FORECAST

The aforementioned information on domestic and external economic developments obtained since the April forecast was drawn up has changed the forecast for the Czech economy. The pressures from the real economy – captured by the real marginal cost gap – will be inflationary in the remainder of this year (see Chart IV.1). The inflationary effect of the real economy will gradually weaken in 2008.

The first component of real marginal costs – the output gap – will be inflationary over the entire forecast horizon. In the remainder of this year, the output gap will widen further into positive figures, primarily because of easy monetary conditions in the exchange rate component. Fiscal policy will also contribute to higher economic growth this year. External demand will have a roughly neutral or slightly anti-inflationary effect on the domestic output gap. Under these assumptions, real GDP growth will be 6.2% this year. Owing to a tightening of monetary and fiscal policy, the output gap will start to close in 2008. If these forecast assumptions are met, GDP growth will slow to 5.4% in 2008 (see Chart IV.2).

Turning to the components of future economic growth, household consumption will play the most important role this year, growing by 6.1% (see Table IV.2). 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. Growth in consumption will also be supported by continuing employment growth (see Table IV.3). In 2008, however, the rate of growth of real consumer spending will fall to roughly 4%, owing to a decrease in real wage growth and employment growth, a tightening of the interest rate component of the monetary conditions and an unwinding of the effect of social transfers from the previous year.

Economic growth in 2008 is likely to be affected, to a greater extent, by the contribution from investment, whereas household consumption growth will slow down. Investment activity will be supported over the entire forecast horizon primarily by continuing growth in external demand, inflow of foreign direct investment and easy real monetary conditions. However, the July forecast slightly lowers the estimate for fixed investment growth in 2007, owing to temporarily lower fixed capital formation in 2007 Q1. Gross fixed capital formation will thus grow by roughly 7% in 2007, but in 2008 the rate of growth will pick up again to almost 10%.

The forecast still assumes a growth trend in export performance, connected with FDI inflow and related changes on the supply side of the economy. An easier real exchange rate and a more optimistic outlook for external demand will lead to a rise in real export growth this year by comparison with the April forecast, to roughly 14%. In 2008, real export growth will decline to 13% owing to a downturn in external demand. Robust domestic demand growth coupled with a high import intensity of exports will result in year-on-year real import growth of 14.5% in 2007. Owing to lower domestic demand growth, import growth will slow somewhat to roughly 12% in 2008, lagging only slightly behind export growth.

The second component of the real marginal cost gap – the real wage gap – will have a roughly neutral effect on inflation this year and will turn anti-inflationary in 2008. Although the forecast expects a continuing decline in unemployment and high growth in the average nominal wage in the business sector (of 8% in 2007 and 8.7% in 2008), rising inflation will cause growth in real wages to lag behind their equilibrium growth rate.

In the remainder of 2007, 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 start prevailing in the course of 2008 and a trend of moderate nominal appreciation of the exchange rate will be renewed.

The July inflation forecast is higher than the April forecast. This revision reflects the inflationary signals arriving from the Czech and external economies in the last quarter. The forecast of higher import prices will materialise in the next few quarters, and the lagged inflationary effects of the real economy in the longer run. Headline inflation will rise in the second half of this year, being affected by all its components (see Table IV.4), and will reach 3.8% at the year-end. The inflation pressures from the real economy will ease off a little during 2008, but will continue to foster rising inflation. The contribution of administrative effects to inflation will peak in 2008 Q1. The pick-up in headline inflation to just above 4% in 2008 will also be due to a rise in inflation expectations, affected by the lagged impacts of these factors. Inflation will not start returning to the target until 2009, when an appreciation of the exchange rate and a modest decline in the pressures from the real economy will

Tab. IV.2
Household consumption will significantly contribute to economic growth
(annual percentage changes)

	2007	2008
GROSS DOMESTIC PRODUCT	6.2	5.4
Household consumption	6.1	4.3
Government consumption	1.3	-0.4
Gross fixed capital formation	6.9	9.6
Imports of goods and services	14.5	12.3
Exports of goods and services	14.2	13.0
Net exports of goods and services (in CZK bn; at constant prices)	-19.6	-3.1

Table IV.3
Wage growth in the business sector will accelerate
(annual percentage changes)

	2007	2008
Real gross disposable income of households	5.9	4.1
Total employment	1.2	0.4
Unemployment rate (in per cent) a)	5.7	5.3
Labour productivity	4.8	5.0
Average nominal wage	7.4	7.7
Average nominal wage in business sector	8.0	8.7
Current account deficit (ratio to GDP in per cent)	-3.4	-3.2
M2	9.1	6.6

a) ILO methodology

Table IV.4
Adjusted inflation excluding fuels will pick up pace in the coming period
(annual percentage changes; quarterly averages)

	III/07	IV/07	I/08	II/08	III/08	IV/08	I/09
CONSUMER PRICES	2.7	3.8	4.3	4.1	4.2	4.2	3.9
Regulated prices	4.4	5.6	6.5	5.8	5.6	5.5	4.5
First-round impacts of indirect tax changes on consumer prices a)	0.8	1.1	1.1	1.0	0.8	0.6	0.4
Monetary-policy relevant inflation b)	1.8	2.7	3.2	3.2	3.4	3.7	3.6
Breakdown into contributions:							
prices of food, beverages, tobacco	1.9	2.4	2.4	2.6	3.0	3.3	3.1
adjusted inflation excl. fuels	1.2	1.9	2.6	3.1	3.4	3.5	3.3
fuel prices	-3.4	2.3	8.0	0.9	0.8	5.7	5.6

a) contributions in percentage points
b) inflation excluding first-round impacts of changes to indirect taxes

Chart IV.3
The inflation forecast lies slightly above the upper boundary of the inflation-target tolerance band at the monetary policy horizon
(annual percentage changes in CPI)

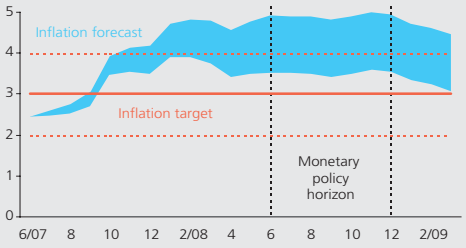
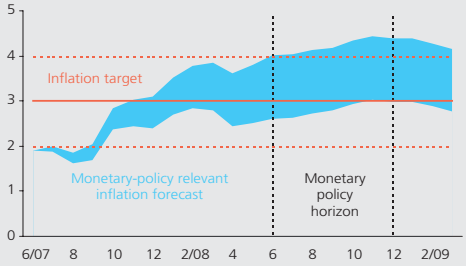


Chart IV.4
Monetary-policy relevant inflation lies in the upper half of the inflation-target tolerance band at the monetary policy horizon
(annual percentage changes)



emerge. At the monetary policy horizon, i.e. in 2008 H2, inflation will be above the upper boundary of the tolerance band for the inflation target (see Chart IV.3).

In the coming years, like this year, inflation will be significantly affected by the impacts of tax changes stemming from the need to harmonise indirect taxes with EU regulations. In addition to the changes to excise duties on tobacco products taken into account in previous forecasts, environmental taxes have been newly incorporated into the forecast. The average first-round effect of changes to indirect taxes on annual inflation will be 0.7 percentage points at the monetary policy horizon. The mechanism of caveats applies as usual to the first-round effects of changes to indirect taxes. Adjusted for these effects, monetary-policy relevant inflation is in the upper half of the tolerance band for the inflation target at the monetary policy horizon, at an average value of 3.6% (see Chart IV.4).

Consistent with the macroeconomic forecast and its assumptions is growth in nominal interest rates.

During the preparation of the forecast, the standard sensitivity scenario for the impact of a deviation of the exchange rate on the forecast was drawn up, and an alternative scenario capturing the uncertainty concerning inflation expectations was discussed.

The baseline scenario assumes a relatively rapid increase in inflation expectations. The alternative scenario considers the situation where inflation expectations are affected by consumers' long-term experience with low adjusted inflation excluding fuels and low food price inflation. This experience may lead to lower expected inflation than in the baseline scenario and to the absence of the pass-through of the tax changes to inflation expectations.

Thanks to these lower inflation expectations, in the alternative scenario, headline inflation and monetary-policy relevant inflation are lower, and the interest rate response is somewhat softer, than in the baseline scenario. The real marginal cost gap is slightly more positive, as a result of faster growth in real wages. However, its more inflationary effect as compared to the baseline scenario is outweighed by lower inflation expectations.

IV.4 EXPECTATIONS OF ECONOMIC AGENTS

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

	6/06	3/07	4/07	5/07	6/07
CONSUMER PRICES					
1Y horizon:					
Financial market	2.8	3.2	3.1	3.2	3.2
Corporations	2.9	3.0			3.0
3Y horizon:					
Financial market	2.4	2.5	2.5	2.5	2.5
Corporations	3.1	3.1			2.9
1Y PRIBOR					
1Y horizon:					
Financial market	2.9	3.4	3.4	3.6	3.8

The CNB monitors the inflation expectations of two sectors (the financial market and corporations) at the one-year and three-year horizons by means of statistical surveys. Box 2 deals with the inflation expectations of the household sector.

Future inflation expected by financial market participants at the one-year horizon remained slightly above the CNB's target of 3%. Analysts predict that the main inflation factors will be demand-pull inflationary pressures (wage growth and household consumption). The inflation expectations of corporations are unchanged and remain consistent with the inflation target. At the three-year horizon, the inflation expectations of both the financial market and corporations are below the CNB's inflation target of 3%, but above the new target of 2% valid as from January 2010.

In Q2, the interest rates expected by financial analysts increased at all the monitored maturities. The interest rate path consistent with the aforementioned CNB forecast was slightly above the expectations of financial market analysts in the near future. At the longer horizon, it was higher.

BOX 2
The CNB's new approach to the monitoring of inflation expectations of households in the Czech Republic

The CNB has monitored the inflation expectations of households since 1999. Expected inflation at the one-year and three-year horizons has been acquired by means of regular surveys. Recently, however, the values of this indicator have been highly volatile and have failed to give a clear picture of inflation expectations.

Starting in July 2007, the CNB will abandon this quantitative approach to monitoring inflation expected by households and will use a qualitative assessment of past inflation and future inflation expected by households. These indicators are collected as part of the European Commission Business and Consumer Survey, which is conducted monthly in the Czech Republic on a sample of 1,000 respondents.

The respondents are asked to provide their assessment of consumer price developments in the past 12 months and their expectations regarding consumer prices in the next 12 months. The six categories of responses are given in Table 1.

Overall indices of perceived inflation and inflation expectations of consumers are then constructed as the balance of the responses, where PP, P, M and MM are the percentages of the total of each type of response (see Table 1):

$$B = (PP + 1/2P) - (1/2M + MM)$$

For the assessment of past inflation, the balance is the difference between the weighted share of the respondents who feel that prices rose more than "slightly" and those who think prices did not rise. For inflation expectations, it is the difference between the weighted share of the respondents who expect inflation to be at least at the past 12 months' level in the next 12 months, and those who expect it to be zero or negative. The balance can theoretically range between -100 and +100. From the outlook balance and by comparison with the assessment of perceived inflation, one can judge whether the number of consumers that expect inflation to rise is increasing. Although this indicator does not provide specific expected inflation outturns, it has the aforementioned advantage of allowing expectations to be compared with the assessment of past developments.

Chart 1 shows the entire time series of perceived and expected inflation for the Czech Republic. It can be seen that perceived inflation as measured by the European Commission index has been declining since 1998. According to this indicator, Czech consumers have on average tended to think since 2002 that prices are not increasing. The balance of the responses regarding future inflation has been relatively low since mid-2004. The number of respondents expecting faster future price growth than in the past has not been much higher than those not expecting prices to rise. A slight upward trend can be seen in this indicator as from mid-2005.

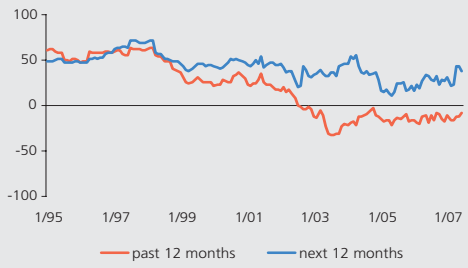
The average quarterly value of the indicator of expected inflation increased by 15 points in 2007 Q2, amid a slight rise in the indicator of perceived inflation. This indicates a relatively significant shift in the responses towards higher expected inflation.

Table 1 (Box)
The answers in the survey of perceived and expected inflation are in six categories

	How do you think that consumer prices have developed over the last 12 months? They have...	By comparison with the past 12 months, how do you expect that consumer prices will develop in the next 12 months? They will...
PP	risen a lot	increase more rapidly
P	risen moderately	increase at the same rate
0	risen slightly	increase at a slower rate
M	stayed about the same	stay about the same
MM	fallen	fall
N	don't know	don't know

Source: European Commission Business and Consumer Survey

Chart 1 (Box)
The indicator of expected inflation rose in 2007 Q2



Source: European Commission Business and Consumer Survey

MINUTES OF THE BOARD MEETING ON 31 MAY 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), P. Řežábek (Chief Executive Director)

The Board discussed the May situation report assessing the new data on the economy and the risks associated with the fulfilment of the April macroeconomic forecast. These risks were assessed in the situation report as being on the upside overall. Annual consumer price inflation had risen to 2.5% in April and was thus 0.4 percentage points higher than forecasted. This deviation was due to higher-than-forecasted growth in food prices, greater-than-forecasted impacts of changes to indirect taxes, faster-than-forecasted growth in regulated prices and higher-than-forecasted adjusted inflation excluding fuels. Figures from the real economy suggested a risk of higher-than-expected GDP growth in the first quarter of 2007. This was confirmed by developments in the labour market, where employment growth had accelerated and the unemployment rate had fallen.

After the presentation of the situation report, the Board discussed the risks associated with the April forecast, consistent with which is a gradual rise in interest rates. The majority of the board members agreed that the past downside risks to inflation were abating. In this context, it was argued that these downside risks had allowed interest rates to be kept below their equilibrium level and that their abatement meant convergence of current interest rates to these monetary policy neutral rates.

There was a discussion about whether the upside risks of the forecast associated with the evolution of the domestic economy were already starting to materialise. Some of the board members felt that the expected higher GDP growth coupled with pressures from the labour market would lead to mounting inflation pressures, which had already partially manifested themselves in the higher inflation in April. Against this, the opinion was expressed that the high growth in construction and industry might have been due to the unusually good weather in the first quarter, which would not necessarily recur. The higher-than-forecasted rise in the consumer price index might thus have been due to a combination of several factors that were not linked with monetary policy, such as shifts in the seasonality of food prices, shifts in the timing of the impacts of the increase in indirect taxes and the of the rise in regulated prices, etc.

The Board also discussed the labour market figures. The relatively sharp fall in the general unemployment rate compared to the forecast was identified as an upside factor, as it might lead to higher wage growth. On the other hand, however, mention was made of the persisting downside effect of the still falling nominal unit wage costs in industry and construction due primarily to rapid labour productivity growth. In this context, however, the opinion was also expressed that some of the structural changes in the labour market, for example the greater involvement of employment agencies, might have led to this factor being overestimated.

In the light of the effects on economic growth and inflation in the Czech Republic, the Board also discussed the pick-up in economic growth in the euro area and the related revision of the external growth prospects. The distribution of this additional growth impulse between potential output growth and cyclical growth was discussed. In this context, it was said that no upside effects of the higher euro area GDP growth on other economic indicators in this region (core inflation, wages, household incomes) were apparent so far. Against this, it was argued that the higher GDP growth abroad would lead to an increase in foreign interest rates and hence to an increase in the interest rate differential, which might then affect capital flows and cause the koruna exchange rate to depreciate or remain weaker than forecasted. At the same time, however, concerns were expressed that an interest rate increase by the CNB might restart the Czech koruna's appreciation trend. The board members nonetheless agreed that the shift in the risks of the forecast was linked more with domestic economic factors than with external ones.

The Board also discussed the uncertainties associated with the fiscal policy settings. It was said that, aside from the impacts of the indirect tax increases, the planned reform of public finances would also probably generate a slowdown in demand-pull inflation impulses. The discussion also covered the cost factors of inflation linked with the increased outlook for oil prices and the higher-than-expected industrial producer price index. According to some of the board members, the current oil price trend is due to one-off factors that should not be overvalued. On the other hand, though, cost pressures were now emerging among other cost prices in the producer price index as well.

At the close of the meeting the Board decided to increase the CNB two-week repo rate by 0.25 percentage points to 2.75%, effective 1 June 2007. At the same time it decided to increase the discount rate and Lombard rate by the same amount, to 1.75% and 3.75% respectively. Three members voted in favour of this decision, and three members voted for leaving rates unchanged. In compliance with the Bank Board's Rules of Procedure the chairman casts the decisive vote for a tie-vote situation.

MINUTES OF THE BOARD MEETING ON 28 JUNE 2007

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

The meeting opened with a presentation of the June situation report analysing the new statistical data and assessing the risks to the fulfilment of the current macroeconomic forecast. According to the situation report, the risks to inflation were now on the upside. The underlying domestic factors included new information from the labour market, including faster wage growth, along with an upswing in economic growth and higher-than-forecasted inflation. Expected external economic growth had picked up pace and expected interest rates in the euro area had risen. Another moderate upside risk to inflation was the exchange rate of the koruna, which was weaker than assumed in the current macroeconomic forecast. The situation report did not identify any major downside risks to inflation.

After the presentation, the Board discussed the situation report. The majority of the members agreed that the balance of risks was tilted towards the upside. The Board focused in detail on the current labour market situation and its relationship to the current phase of the business cycle. Wage growth, which in many cases will probably be faster this year than indicated by information from collective bargaining, was discussed. In this context, it was said that there were signs of tension in the labour market, as in some branches of industry and construction it was proving difficult to saturate the high demand for workers. The prevailing view in the discussion was that the newly observed growth in nominal unit wage costs in industry was indicating wage-cost pressures. It was also said, however, that temporarily increased nominal unit wage costs can also be a sign that businesses are gearing up for a further strengthening of demand, and the opinion was expressed that faster-growing wages can be natural for a converging economy.

In a debate on the newly published GDP figures it was said that the rapid economic growth was continuing, and the view was presented that a further increase in domestic demand growth could be expected. The opinion was expressed that rapid economic growth should not be a reason for tightening monetary policy. Against this, however, it was said that this had not been the case in the past either, when increases in output growth had been largely explained by revisions to the estimate of the potential, non-accelerating inflation level of output. It was also pointed out that the economic growth figures for previous years had been revised upwards. The opinion was expressed that potential output growth would therefore be raised in the new forecast and that this could also entail a re-assessment of inflation pressures.

The Board moved on to discuss the inflation risks stemming from the exchange rate, which was weaker than forecasted, and the link between the exchange rate and the size of the interest rate differential. It was said that previously the exchange rate had helped to depress inflation, whereas now its growing deviation from the forecast was an additional inflationary factor. It was also said that the koruna had some time ago split off from the other regional currencies and started to weaken gradually amid low volatility. The opinion was expressed that unless the interest rate differential narrowed this trend would probably continue. Against this, however, it was said that in response to new data, and probably also thanks to past CNB communications, the slope of the koruna yield curve had increased and the interest rate differential had narrowed somewhat as a result. It was also said in the debate that the effect of the interest rate differential should not be overestimated and that in the past it had not been a deciding factor as regards monetary policy.

Another of the upside factors debated was the observed higher agricultural producer price inflation. In this context, however, it was said that the ensuing risk was reduced by the high volatility of this indicator as compared to the volatility of food price inflation, and also by the fact that agricultural producer prices affect food prices to only a minor extent. The impacts of a further potential rise in energy prices was also discussed. This rise might be significantly faster than previously assumed. It was also said that in addition to the direct inflationary effect, rising energy prices could have a negative impact on economic growth, thereby depressing this direct effect.

Given the upside balance of risks to inflation, the Board discussed the possibility of raising interest rates. The opinion was expressed that overall the upside risks of the current forecast were sufficiently conclusive and quantitatively significant and that the July forecast would in all probability lead to a recommendation of a faster

rise in rates than the April forecast. The appropriate response should therefore be to raise rates already at the present meeting. Against this, the opinion was expressed that the new forecast might provide a new view of the future, that apart from the movement of the exchange rate to weaker values the situation in the economy had not changed qualitatively since last month, and that monetary policy should not react hastily to short-term exchange rate fluctuations. It was also said in the debate that the new data could also be interpreted as meaning less intense inflation pressure and that the situation thus did not necessitate an immediate interest rate increase. It was also said that the risk of error arising from not raising rates was not particularly significant.

After discussing the situation report, the Board decided by a majority vote to leave the CNB two-week repo rate unchanged at 2.75%. Four members voted in favour of this decision, and one member voted for increasing rates by 0.25 percentage point.

MINUTES OF THE BOARD MEETING ON 26 JULY 2007

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

The meeting opened with a presentation of the new macroeconomic forecast. Newly acquired information on developments at home and abroad had moved the macroeconomic forecast upwards in all its components. The real economy would have an upside effect on inflation for the remainder of the year. The existence of a positive output gap and a further gradual widening of that gap this year, along with expectations regarding external economic developments and the effect of fiscal policy, had led to the economic growth forecast being increased above 6% for 2007. The growth was then expected to ease slightly to around 5.5% in 2008. In 2007, therefore, the economy would grow at a faster pace than the expected rate of growth of potential output. Domestic consumption would become the most significant component of economic growth this year, bolstered by a high rate of growth of real wages and social transfers. In 2008, the economic growth was expected to be driven by investment. Expectations of high real export growth would be offset by high real import growth. Net exports would thus contribute only minimally to real GDP growth.

The inflationary signals from the domestic and external economies had pushed the inflation forecast upwards compared to April. In the next few quarters the inflation forecast primarily reflected an increase in the forecast for import prices, whereas in the longer run the lagged effects of the real economy would emerge. Like this year, however, the future course of inflation would be significantly affected by the impacts of tax changes. The introduction of "environmental" taxes had also been newly incorporated into the forecast. The contribution from administrative effects would peak in the first quarter of 2008. In the second half of this year, inflation would thus accelerate in all its components, and at the monetary policy horizon, i.e. in the second half of 2008, it would lie above the upper boundary of the tolerance band for the inflation target. Monetary-policy relevant inflation in the same period would be in the upper half of the tolerance band, while showing a gradual return to the centre of the band.

Consistent with the macroeconomic forecast and its assumptions was growth in nominal interest rates.

The presentation of the new macroeconomic forecast was followed by a discussion of the risks and uncertainties associated with the forecast. In the discussion of the starting points of the forecast, it was said that the economy was going through a phase of dynamic economic growth, which, unlike in the past, was being accompanied by an economic upswing abroad. The outlook for foreign interest rates had also increased and this was adding to the depreciation pressures on the exchange rate. It was said that information from the labour market was confirming the forecast of strong domestic demand growth, and the observed growth of the money supply was also mentioned as an upside factor. On the other hand, however, the opinion was also expressed that the relatively buoyant economic growth had not yet fostered increased inflation pressures and it was not entirely certain that this situation would not continue to apply.

A majority of the board members concurred that there had been a comparatively sizeable upward revision of the forecast, including for the implied interest rate path. However, it was not possible to identify a single strong factor underlying this revision. It seemed, rather, that there were numerous minor inflationary effects involved. By contrast, the sole downside factor to have materialised was the koruna-dollar exchange rate. It was said, however, that the forecast had come as no surprise, given the observed economic developments. In this context, it was said that the April forecast, which was being fulfilled at its upper limit, had expected a rising interest rate path. As a counter-argument, however, it was said that if the April forecast was being met, there was no clear reason to revise the current forecast by comparison with April.

One of the items discussed was the downside effect of the stable inflation expectations in response to the tax changes. It was said that in an economy where inflation had long been close to the inflation target, inflation expectations were well anchored. The monetary policy response could thus be more gradual.

The expected exchange rate path was identified as a potential downside risk of the forecast. It was said that in a situation of expected closure of the interest rate differential, faster-than-forecasted appreciation of the koruna could not be ruled out. This risk could be augmented by any rise in interest rates beyond the framework expected by the financial market. Given that part of the upward revision of the forecast was due to an increase in import prices, an appreciation of the exchange rate would probably change the outlook for future inflation. It was said that some degree of caution was therefore appropriate in this situation. At the same time, however, it was also said that exchange rate fluctuations in either direction were natural in a small open economy and that a central bank targeting inflation and not the exchange rate should not be overly concerned by short-term exchange rate volatility.

In this context, the Board debated at some length the magnitude of any interest rate increase and its impact on the financial markets and also the impact of today's decision on the future monetary policy settings. In this discussion, the opinion was expressed that stronger monetary policy responses would be appropriate primarily in the event of economic shocks. It was also said that fulfilment of the current forecast was a required condition for a further tightening of monetary policy. However, a majority of the board members agreed on the need for another interest rate increase if the current forecast was met.

At the close of the meeting the Board decided by a majority vote to increase the CNB two-week repo rate by 0.25 percentage point to 3.0%, effective 27 July 2007. At the same time it decided to increase the discount rate and Lombard rate by the same amount, to 2.0% and 4.0% respectively. Six members voted in favour of this decision, and one member voted for increasing the rates by 0.5%.

Table 1a

INFLATION DEVELOPMENT												annual percentage changes
2003	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**
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*
First-round impacts of changes to indirect taxes on												
consumer 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*
Monetary-policy relevant inflation [1]	-0.4	-0.4	-0.4	-0.1	0.0	0.3	-0.1	-0.1	0.0	0.4	1.0	1.0
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 excluding fuels	1.2	1.2	1.1	1.0	1.0	0.6	0.1	0.2	0.2	0.2	0.2	0.2
(contribution to consumer price inflation)	*0.64*	*0.63*	*0.54*	*0.53*	*0.49*	*0.31*	*0.05*	*0.11*	*0.10*	*0.11*	*0.10*	*0.11*
fuel prices	6.1	10.5	11.4	1.9	-0.5	-1.2	-0.5	0.6	-2.5	-2.9	-2.8	-2.0
(contribution to consumer price inflation)	*0.10*	*0.25*	*0.27*	*0.03*	*-0.03*	*-0.04*	*-0.02*	*0.01*	*-0.07*	*-0.07*	*-0.07*	*-0.04*
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)												
First-round impacts of changes to indirect taxes on	*1.01*	*0.99*	*0.96*	*0.64*	*0.50*	*0.50*	*0.50*	*0.47*	*0.47*	*0.91*	*0.90*	*0.90*
consumer prices (contribution to consumer price inflation)	*0.69*	*0.69*	*0.69*	*0.73*	*0.77*	*0.84*	*0.88*	*0.89*	*0.92*	*0.92*	*0.92*	*0.92*
Monetary-policy relevant inflation [1]	1.6	1.6	1.8	1.6	2.0	2.0	2.4	2.5	2.1	2.6	2.0	1.9
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*	*0.90*	*0.71*	*1.00*	*1.10*	*0.78*	*0.59*	*0.18*	*0.25*
adjusted inflation excluding fuels	0.6	0.7	0.9	0.9	1.0	1.4	1.4	1.4	1.6	1.6	1.6	1.6
(contribution to consumer price inflation)	*0.32*	*0.36*	*0.47*	*0.43*	*0.51*	*0.69*	*0.72*	*0.74*	*0.81*	*0.81*	*0.80*	*0.79*
fuel prices	-4.3	-7.0	-5.6	-3.3	7.9	11.0	10.6	9.7	7.4	11.2	10.5	5.9
(contribution to consumer price inflation)	*-0.11*	*0.19*	*-0.15*	*-0.09*	*0.23*	*0.30*	*0.29*	*0.28*	*0.21*	*0.31*	*0.29*	*0.16*
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*
First-round impacts of changes to indirect taxes on												
consumer prices (contribution to consumer price inflation)	*0.17*	*0.17*	*0.17*	*0.13*	*0.09*	*0.02*	*-0.02*	*-0.03*	*-0.06*	*-0.06*	*-0.05*	*0.00*
Monetary-policy relevant inflation [1]	1.5	1.5	1.4	1.5	1.2	1.7	1.7	1.8	2.3	2.7	2.5	2.2
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 excluding fuels	1.1	1.1	0.9	0.9	0.9	0.8	0.5	0.6	0.7	0.6	0.5	0.5
(contribution to consumer price inflation)	*0.55*	*0.53*	*0.43*	*0.45*	*0.45*	*0.40*	*0.27*	*0.29*	*0.33*	*0.27*	*0.24*	*0.23*
fuel prices	2.2	2.1	1.4	8.9	1.1	2.7	8.2	8.3	21.6	16.1	11.4	9.8
(contribution to consumer price inflation)	*0.06*	*0.05*	*0.04*	*0.23*	*0.03*	*0.08*	*0.23*	*0.23*	*0.60*	*0.46*	*0.32*	*0.26*
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*
First-round impacts of changes to indirect taxes on												
consumer 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*
Monetary-policy relevant inflation [1]	2.7	2.5	2.4	2.5	2.7	2.4	2.5	2.9	2.5	1.1	1.3	1.6
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 excluding fuels	0.6	0.5	0.5	0.5	0.5	0.3	0.5	0.7	0.7	0.6	0.6	0.8
(contribution to consumer price inflation)	*0.32*	*0.28*	*0.26*	*0.27*	*0.26*	*0.14*	*0.25*	*0.35*	*0.33*	*0.31*	*0.32*	*0.39*
fuel prices	12.5	13.9	10.9	7.3	10.4	8.3	5.7	6.0	-7.5	-10.8	-8.4	-3.4
(contribution to consumer price inflation)	*0.32*	*0.36*	*0.29*	*0.21*	*0.30*	*0.24*	*0.17*	*0.18*	*-0.25*	*-0.36*	*-0.27*	*-0.10*
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
2007								**forecast**				
Consumer prices	1.3	1.5	1.9	2.5	2.4	2.5	2.5	2.6	2.9			
Regulated prices	3.9	4.3	4.1	4.7	4.0	4.0	4.2	4.3	4.6			
(contribution to consumer price inflation)	*0.66*	*0.72*	*0.70*	*0.80*	*0.69*	*0.68*	*0.71*	*0.73*	*0.78*			
First-round impacts of changes to indirect taxes on												
consumer prices (contribution to consumer price inflation)	*0.10*	*0.11*	*0.21*	*0.33*	*0.45*	*0.55*	*0.60*	*0.89*	*1.02*			
Monetary-policy relevant inflation [1]	1.2	1.4	1.7	2.2	1.9	1.9	1.9	1.7	1.9			
of which: prices of food, beverages and tobacco	2.0	2.7	3.2	4.1	3.5	2.7	2.1	1.7	1.9			
(contribution to consumer price inflation)	*0.48*	*0.67*	*0.78*	*1.01*	*0.85*	*0.67*	*0.53*	*0.43*	*0.47*			
adjusted inflation excluding fuels	0.3	0.4	0.6	0.8	0.8	1.0	1.2	1.2	1.3			
(contribution to consumer price inflation)	*0.19*	*0.20*	*0.34*	*0.43*	*0.46*	*0.57*	*0.68*	*0.64*	*0.69*			
fuel prices	-3.5	-6.6	-3.1	-3.6	-2.9	-1.7	-2.5	-4.8	-3.0			
(contribution to consumer price inflation)	*-0.14*	*-0.26*	*-0.12*	*-0.15*	*-0.12*	*-0.07*	*-0.11*	*-0.21*	*-0.13*			
Inflation rate (annual moving average)	2.4	2.3	2.2	2.2	2.2	2.1	2.1	2.0	2.1			

CNB calculation based on CZSO data
1) Monetary-policy relevant inflation = headline inflation adjusted for first-round impacts of changes to indirect taxes

Table 1b

INFLATION DEVELOPMENT monthly percentage changes

2003	1	2	3	4	5	6	7	8	9	10	11	12
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*
First-round impacts of changes to indirect taxes on												
consumer 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*
Monetary-policy relevant inflation [1]	0.6	0.2	-0.1	0.2	0.0	0.0	0.1	-0.2	-0.5	0.1	0.5	0.2
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 excluding fuels	0.6	0.2	-0.2	0.0	-0.1	-0.1	1.0	0.2	-1.4	0.1	0.0	0.0
(contribution to consumer price inflation)	*0.29*	*0.12*	*-0.11*	*-0.02*	*-0.07*	*-0.05*	*0.50*	*0.12*	*-0.70*	*0.06*	*-0.02*	*0.00*
fuel prices	1.6	2.3	1.4	-1.5	-2.8	-2.4	-0.9	1.2	1.6	-0.9	-0.6	-0.7
(contribution to consumer price inflation)	*0.04*	*0.06*	*0.04*	*-0.04*	*-0.08*	*-0.06*	*-0.03*	*0.03*	*0.05*	*-0.03*	*-0.02*	*-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*
First-round impacts of changes to indirect taxes on												
consumer prices (contribution to consumer price inflation)	*0.69*	*0.00*	*0.00*	*0.04*	*0.05*	*0.07*	*0.04*	*0.01*	*0.03*	*0.00*	*0.00*	*0.00*
Monetary-policy relevant inflation [1]	1.2	0.2	0.1	-0.1	0.4	0.1	0.3	0.0	-0.8	0.5	-0.1	0.1
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 excluding fuels	1.0	0.3	0.0	-0.1	0.0	0.3	1.0	0.2	-1.2	0.1	0.0	0.0
(contribution to consumer price inflation)	*0.50*	*0.16*	*0.00*	*-0.06*	*0.01*	*0.13*	*0.52*	*0.13*	*-0.61*	*0.06*	*-0.01*	*-0.01*
fuel prices	-0.8	-0.6	3.0	0.9	8.5	0.4	-1.2	0.4	-0.6	2.6	-1.2	-4.9
(contribution to consumer price inflation)	*-0.02*	*-0.02*	*0.08*	*0.02*	*0.22*	*0.01*	*-0.04*	*0.01*	*-0.02*	*0.07*	*-0.04*	*-0.14*
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*
First-round impacts of changes to indirect taxes on												
consumer 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*
Monetary-policy relevant inflation [1]	0.7	0.2	-0.1	0.1	0.2	0.6	0.3	0.0	-0.3	0.9	-0.3	-0.2
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 excluding fuels	0.5	0.3	-0.2	-0.1	0.0	0.2	0.8	0.3	-1.1	0.0	-0.1	-0.1
(contribution to consumer price inflation)	*0.25*	*0.13*	*-0.09*	*-0.05*	*0.01*	*0.08*	*0.38*	*0.14*	*-0.57*	*0.01*	*-0.05*	*-0.03*
fuel prices	-4.3	-0.7	2.3	8.4	0.7	1.9	4.1	0.4	11.6	-2.0	-5.2	-6.3
(contribution to consumer price inflation)	*-0.12*	*-0.02*	*0.06*	*0.22*	*0.02*	*0.06*	*0.12*	*0.01*	*0.35*	*-0.07*	*-0.17*	*-0.20*
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*
First-round impacts of changes to indirect taxes on												
consumer 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*
Monetary-policy relevant inflation [1]	1.2	0.0	-0.2	0.1	0.5	0.3	0.4	0.3	-0.7	-0.5	-0.1	0.2
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 excluding fuels	0.7	0.2	-0.2	-0.1	0.0	-0.1	1.0	0.5	-1.2	0.0	-0.1	0.1
(contribution to consumer price inflation)	*0.35*	*0.08*	*-0.11*	*-0.03*	*0.01*	*-0.03*	*0.48*	*0.24*	*-0.57*	*-0.02*	*-0.04*	*0.04*
fuel prices	-2.0	0.5	-0.5	4.8	3.6	0.0	1.6	0.7	-2.6	-5.5	-2.7	-1.2
(contribution to consumer price inflation)	*-0.60*	*0.02*	*-0.01*	*0.14*	*0.11*	*0.00*	*0.05*	*0.02*	*-0.08*	*-0.17*	*-0.08*	*-0.03*
2007								**forecast**				
Consumer prices	1.0	0.3	0.3	0.7	0.4	0.3	0.6	0.3	-0.4			
Regulated prices	3.2	0.6	0.0	0.6	0.3	0.1	0.2	0.3	0.2			
(contribution to consumer price inflation)	*0.54*	*0.10*	*0.01*	*0.11*	*0.05*	*0.01*	*0.03*	*0.05*	*0.03*			
First-round impacts of changes to indirect taxes on												
consumer prices (contribution to consumer price inflation)	*0.10*	*0.14*	*0.15*	*0.12*	*0.12*	*0.10*	*0.06*	*0.11*	*0.13*			
Monetary-policy relevant inflation [1]	0.9	0.1	0.2	0.6	0.3	0.2	0.5	0.2	-0.6			
of which: prices of food, beverages and tobacco	1.2	0.2	0.1	1.0	0.0	0.1	-0.7	-0.2	0.0			
(contribution to consumer price inflation)	*0.30*	*0.04*	*0.02*	*0.24*	*0.01*	*0.03*	*-0.18*	*-0.05*	*0.00*			
adjusted inflation excluding fuels	0.3	0.2	0.0	0.1	0.1	0.1	1.2	0.4	-1.1			
(contribution to consumer price inflation)	*0.14*	*0.11*	*0.01*	*0.05*	*0.04*	*0.07*	*0.62*	*0.22*	*-0.58*			
fuel prices	-2.1	-2.6	3.3	4.3	4.3	1.3	0.8	-1.7	-0.8			
(contribution to consumer price inflation)	*-0.08*	*-0.10*	*0.12*	*0.16*	*0.17*	*0.05*	*0.03*	*-0.07*	*-0.03*			

CNB calculation based on CZSO data
1) Monetary-policy relevant inflation = headline inflation adjusted for first-round impacts of changes to indirect taxes

Table 2

CONSUMER PRICES percentage changes; average for 2005 = 100

Group	Constant 2005 weights in per mille	Months 1	2	3	4	5	6	7	8	9	10	11	12	Average since start of year
Total - 2004	1,000.0	-2.5	-2.3	-2.3	-2.3	-1.8	-1.6	-1.3	-1.3	-2.1	-1.6	-1.6	-1.6	-1.9
Food and non-alcoholic beverages	162.6	1.3	1.0	1.1	1.4	1.0	1.0	0.3	-0.6	-1.3	-1.3	-1.2	0.5	0.3
Alcoholic beverages and tobacco	81.7	-3.6	-3.5	-3.4	-2.8	-1.2	-0.6	-0.3	-0.1	-0.2	-0.3	-0.4	-0.8	-1.4
Clothing and footwear	52.4	6.9	6.0	6.0	6.1	6.2	6.2	4.7	3.7	4.1	5.4	5.6	5.6	5.5
Housing, water, electricity, gas and other fuels	248.3	-4.4	-4.1	-4.0	-4.4	-4.7	-4.7	-4.4	-4.3	-4.1	-2.9	-2.9	-2.9	-4.0
Furnishings, household equipment and routine maintenance of the house	58.1	3.0	2.8	2.7	2.7	2.2	2.2	1.9	1.7	1.5	1.4	1.2	1.1	2.0
Health	17.9	-9.4	-9.1	-8.7	-8.4	-6.5	-6.2	-6.0	-5.8	-5.4	-6.0	-6.3	-6.3	-7.0
Transport	114.1	-2.3	-2.3	-1.3	-1.3	-0.1	-0.6	-0.9	-1.0	-1.7	-1.2	-1.5	-3.0	-1.4
Communications	38.7	-5.1	-6.0	-6.0	-6.1	-7.2	-7.3	-7.4	-8.5	-8.7	-7.4	-7.5	-7.6	-7.1
Recreation and culture	98.6	-3.5	-2.3	-3.3	-3.9	-3.4	-2.0	3.3	5.2	-2.1	-2.6	-3.0	-3.1	-1.7
Education	6.2	-4.2	-3.8	-3.9	-3.9	-3.6	-3.7	-3.7	-3.7	0.7	0.9	0.9	0.9	-2.3
Hotels, cafés and restaurants	58.4	-8.1	-7.9	-7.6	-7.4	-3.7	-3.4	-3.3	-3.2	-2.4	-2.0	-1.8	-1.7	-4.4
Miscellaneous goods and services	63.0	-2.8	-2.1	-1.6	-1.7	-0.7	-0.4	-0.3	-0.4	-0.5	-0.6	-0.4	-0.4	-1.0
Total - 2005	1,000.0	-0.9	-0.7	-0.8	-0.7	-0.5	0.1	0.3	0.3	0.1	0.9	0.7	0.6	0.0
Food and non-alcoholic beverages	162.6	0.8	0.8	0.7	0.5	1.2	1.4	-0.4	-1.3	-1.5	-1.0	-0.8	-0.4	0.0
Alcoholic beverages and tobacco	81.7	0.1	0.3	0.2	-0.2	-0.2	0.0	-0.1	-0.1	-0.2	-0.1	-0.2	-0.1	0.0
Clothing and footwear	52.4	2.4	1.2	1.0	1.3	1.3	1.1	-0.6	-2.0	-1.9	-1.3	-1.1	-1.4	0.0
Housing, water, electricity, gas and other fuels	248.3	-1.0	-0.9	-0.7	-0.9	-0.9	-0.8	-0.4	-0.3	-0.2	2.0	2.0	2.0	0.0
Furnishings, household equipment and routine maintenance of the house	58.1	0.8	0.6	0.5	0.3	0.2	0.0	-0.2	-0.3	-0.5	-0.5	-0.6	-0.7	0.0
Health	17.9	-2.5	-2.0	-1.6	-1.1	0.3	1.1	1.1	1.3	1.8	0.9	0.6	0.6	0.0
Transport	114.1	-4.0	-4.2	-3.8	-1.3	-1.2	-0.4	1.1	1.2	4.9	4.4	2.6	0.5	0.0
Communications	38.7	-7.6	-8.2	-8.2	-8.3	-8.4	5.9	6.2	6.2	5.6	5.6	5.4	5.4	0.0
Recreation and culture	98.6	-1.3	0.1	-1.1	-2.1	-1.7	-1.1	4.1	6.1	-1.1	-0.1	-0.6	-0.7	0.0
Education	6.2	-1.9	-1.2	-1.1	-1.1	-1.1	-1.2	-1.2	-1.2	2.1	2.7	2.7	2.7	0.0
Hotels, cafés and restaurants	58.4	-1.1	-0.6	-0.4	-0.2	-0.2	-0.2	-0.4	-0.4	0.6	0.9	0.9	0.9	0.0
Miscellaneous goods and services	63.0	-0.4	0.1	0.1	0.1	0.0	-0.1	-0.1	-0.1	-0.1	0.0	0.1	0.1	0.0
Total - 2006	1,000.0	2.0	2.1	2.0	2.1	2.6	2.8	3.3	3.5	2.8	2.2	2.2	2.3	2.5
Food and non-alcoholic beverages	162.6	0.4	0.2	0.0	0.2	0.9	2.3	2.0	1.2	1.0	0.3	0.4	1.5	0.9
Alcoholic beverages and tobacco	81.7	0.9	1.1	1.1	0.9	1.3	1.1	1.2	1.2	1.2	1.3	1.5	0.8	1.1
Clothing and footwear	52.4	-3.7	-4.8	-5.1	-4.9	-5.1	-5.6	-7.6	-8.0	-7.6	-6.8	-6.4	-5.9	-6.0
Housing, water, electricity, gas and other fuels	248.3	5.8	6.1	6.1	6.3	6.4	6.5	6.6	6.6	6.6	6.0	6.0	6.0	6.3
Furnishings, household equipment and routine maintenance of the house	58.1	-0.9	-0.9	-1.1	-1.1	-1.2	-1.4	-1.6	-1.6	-1.6	-1.6	-1.4	-1.4	-1.3
Health	17.9	1.7	2.0	2.8	3.1	4.2	4.9	4.9	7.2	7.5	6.9	6.3	6.3	4.8
Transport	114.1	0.2	0.4	0.2	1.7	2.9	2.8	3.6	3.8	2.8	1.0	0.0	-0.2	1.6
Communications	38.7	6.0	4.0	4.0	1.7	7.3	7.3	8.1	8.7	8.5	8.7	8.5	8.5	6.8
Recreation and culture	98.6	0.7	1.8	0.7	0.1	0.4	0.3	5.5	8.1	1.0	0.2	-0.5	-0.3	1.5
Education	6.2	2.6	2.7	2.6	2.6	2.6	2.6	2.6	2.6	5.2	5.2	5.2	5.2	3.5
Hotels, cafés and restaurants	58.4	1.6	1.9	2.0	2.2	2.4	2.5	2.7	2.9	3.1	3.2	3.3	3.5	2.6
Miscellaneous goods and services	63.0	0.9	1.4	1.6	1.8	1.8	1.8	2.1	2.1	2.1	2.2	2.2	2.2	1.9
Total - 2007	1,000.0	3.3	3.6	3.9	4.6	5.0	5.3							4.3
Food and non-alcoholic beverages	162.6	3.1	3.2	3.3	5.0	4.8	5.0							4.1
Alcoholic beverages and tobacco	81.7	2.6	4.6	6.5	7.7	9.7	10.9							7.0
Clothing and footwear	52.4	-7.3	-7.3	-6.8	-5.7	-5.5	-5.6							-6.4
Housing, water, electricity, gas and other fuels	248.3	8.2	8.5	8.6	9.0	9.3	9.5							8.9
Furnishings, household equipment and routine maintenance of the house	58.1	-1.5	-1.6	-1.6	-1.4	-1.3	-1.4							-1.5
Health	17.9	6.6	6.7	6.7	9.7	10.1	9.9							8.3
Transport	114.1	-0.8	-1.6	-0.4	0.9	2.3	2.9							0.6
Communications	38.7	8.1	8.0	7.9	7.7	7.6	7.5							7.8
Recreation and culture	98.6	1.5	2.3	1.4	0.9	0.8	1.1							1.3
Education	6.2	5.2	5.3	5.3	5.3	5.3	5.3							5.3
Hotels, cafés and restaurants	58.4	4.0	4.2	4.4	4.7	5.0	5.3							4.6
Miscellaneous goods and services	63.0	2.9	3.6	4.0	4.1	4.1	4.0							3.8

Source: CZSO

Table 3

CONSUMER PRICES - TRADABLES AND NONTRADABLES annual percentage changes

2003	1	2	3	4	5	6	7	8	9	10	11	12
Fuel prices	6.1	10.5	11.4	1.9	-0.5	-1.1	-0.6	0.7	-2.5	-2.9	-2.7	-2.0
Other tradables excluding food and fuel prices	-2.3	-2.5	-2.6	-2.7	-2.7	-2.9	-3.0	-3.0	-2.9	-2.7	-2.8	-2.7
Prices of tradables excluding regulated prices	4.0	4.1	3.9	3.9	3.8	3.3	2.4	2.5	2.5	2.4	2.5	2.4
Prices of non-food commodities excluding regulated prices	1.5	1.7	1.6	1.1	0.9	0.5	0.1	0.2	0.1	0.1	0.1	0.1
Prices of tradables - food	-4.1	-3.8	-3.6	-3.5	-2.8	-1.1	-0.8	-0.8	-0.2	0.6	2.5	2.7
Prices of nontradables - 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
2004												
Fuel prices	1.0	-1.9	-0.3	2.0	11.0	14.2	13.7	12.8	10.5	14.4	13.7	8.9
Other tradables excluding food and fuel prices	-2.6	-2.4	-2.2	-2.3	-2.6	-2.6	-2.6	-2.6	-2.9	-2.9	-2.7	-2.8
Prices of tradables excluding regulated prices	3.3	3.3	3.4	3.4	5.2	5.9	5.9	5.9	6.4	6.4	6.3	6.3
Prices of non-food commodities excluding regulated prices	0.9	0.8	1.1	1.1	2.5	2.9	3.0	2.9	3.0	3.2	3.1	2.9
Prices of tradables - food	3.2	3.2	3.5	3.8	3.6	3.1	4.4	4.9	3.7	3.0	1.4	1.6
Prices of nontradables - 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
2005												
Fuel prices	-0.4	-0.6	-1.2	6.1	1.1	2.7	8.2	8.3	21.6	16.1	11.4	9.8
Other tradables excluding food and fuel prices	-3.4	-3.6	-3.8	-3.7	-3.4	-3.1	-2.6	-2.6	-2.4	-2.3	-2.3	-2.3
Prices of tradables excluding regulated prices	5.2	5.2	5.0	5.0	3.5	3.1	2.6	2.6	2.6	2.4	2.3	2.2
Prices of non-food commodities excluding regulated prices	1.6	1.6	1.4	1.8	0.8	0.8	0.8	0.9	1.7	1.3	1.0	0.8
Prices of tradables - food	0.8	1.0	0.8	0.2	0.4	0.4	-0.4	-0.5	-0.2	0.3	0.3	-0.5
Prices of nontradables - 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
2006												
Fuel prices	12.5	13.9	10.9	7.3	10.4	8.3	5.7	6.0	-7.5	-10.8	-8.4	-3.4
Other tradables excluding food and fuel prices	-2.1	-2.1	-2.1	-2.1	-2.1	-2.9	-2.7	-2.6	-2.4	-2.4	-2.3	-2.1
Prices of tradables excluding regulated prices	2.6	2.5	2.4	2.4	2.5	2.2	2.4	2.6	2.5	2.4	2.4	2.5
Prices of non-food commodities excluding regulated prices	1.2	1.2	1.0	0.9	1.0	0.7	0.8	1.0	0.1	-0.1	0.1	0.5
Prices of tradables - food	-0.1	-0.2	-0.3	0.1	0.3	1.0	2.1	2.2	2.2	1.3	1.3	1.6
Prices of nontradables - 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
2007												
Fuel prices	-3.5	-6.6	-3.1	-3.6	-2.9	-1.7						
Other tradables excluding food and fuel prices	-2.4	-2.6	-2.0	-1.6	-1.7	-1.6						
Prices of tradables excluding regulated prices	2.5	2.8	2.9	3.2	2.6	2.8						
Prices of non-food commodities excluding regulated prices	0.1	-0.1	0.4	0.6	0.7	1.0						
Prices of tradables - food	2.4	3.2	4.1	5.5	5.3	5.0						
Prices of nontradables - regulated prices	3.9	4.3	4.1	4.7	4.0	4.0						

CNB calculation based on CZSO data

Table 4

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

	CPI	
	Financial market	Businesses
1/03	2.5	__
2/03	2.4	__
3/03	2.5	2.1
4/03	2.6	__
5/03	3.7	__
6/03	3.2	2.6
7/03	3.3	__
8/03	3.2	__
9/03	3.1	2.6
10/03	3.0	__
11/03	3.1	__
12/03	3.3	2.9
1/04	2.9	__
2/04	3.2	__
3/04	3.0	3.3
4/04	2.8	__
5/04	2.6	__
6/04	2.7	3.1
7/04	2.8	__
8/04	2.8	__
9/04	3.0	3.1
10/04	2.8	__
11/04	2.8	__
12/04	2.8	3.2
1/05	2.8	__
2/05	2.6	__
3/05	2.6	2.7
4/05	2.5	__
5/05	2.4	__
6/05	2.3	2.7
7/05	2.4	__
8/05	2.5	__
9/05	2.5	2.8
10/05	2.7	__
11/05	2.8	__
12/05	2.6	2.8
1/06	2.5	__
2/06	2.5	__
3/06	2.5	2.7
4/06	2.6	__
5/06	2.6	__
6/06	2.8	2.9
7/06	2.9	__
8/06	3.1	__
9/06	3.2	3.0
10/06	3.1	__
11/06	3.4	__
12/06	3.3	3.0
1/07	3.1	__
2/07	3.0	__
3/07	3.2	3.0
4/07	3.1	__
5/07	3.2	__
6/07	3.2	3.0

Source: CNB statistical survey

Table 5

HARMONISED INDEX OF CONSUMER PRICES

annual percentage changes

	2003 12	2004 12	2005 12	2006 12	2007 6
European Union (27 countries)	2.1	2.5	2.3	2.2	2.1
European Union (25 countries)	1.9	2.4	2.1	2.2	2.1
Belgium	1.7	1.9	2.8	2.1	1.3
Bulgaria	5.6	4.0	7.4	6.1	5.3
Czech Republic	0.9	2.5	1.9	1.5	2.6
Denmark	1.2	0.9	2.2	1.7	1.3
Germany	1.0	2.3	2.1	1.4	2.0
Estonia	1.2	4.8	3.6	5.1	6.0
Ireland	3.0	2.4	1.9	3.0	2.8
Greece	3.1	3.1	3.5	3.2	2.6
Spain	2.7	3.3	3.7	2.7	2.5
France	2.4	2.3	1.8	1.7	1.3
Italy	2.5	2.4	2.1	2.1	1.9
Cyprus	2.2	3.9	1.4	1.5	1.7
Latvia	3.5	7.4	7.1	6.8	8.9
Lithuania	-1.3	2.8	3.0	4.5	5.0
Luxembourg	2.4	3.5	3.4	2.3	2.3
Hungary	5.6	5.5	3.3	6.6	8.5
Malta	2.4	1.9	3.4	0.8	-0.6
Netherlands	1.6	1.2	2.0	1.7	1.8
Austria	1.3	2.5	1.6	1.6	1.9
Poland	1.6	4.4	0.8	1.4	2.6
Portugal	2.3	2.6	2.5	2.5	2.4
Romania	14.1	9.3	8.7	4.9	3.9
Slovenia	4.7	3.3	2.4	3.0	3.8
Slovakia	9.4	5.8	3.9	3.7	1.5
Finland	1.2	0.1	1.1	1.2	1.4
Sweden	1.8	0.9	1.3	1.4	1.3
United Kingdom	1.3	1.7	1.9	3.0	

Source: Eurostat

Table 6

MONETARY SURVEY					position at month-end in CZK billions
	2003 12	2004 12	2005 12	2006 12	2007 5
Total assets	1,766.1	1,844.1	1,992.1	2,188.6	2,311.0
Net external assets (NEAs)	821.5	863.3	1,076.4	972.7	1,035.9
NEAs of CNB	687.5	634.1	724.7	659.1	665.6
NEAs of OMFIs	134.0	229.3	351.7	313.5	370.3
Net domestic assets	944.5	980.8	915.8	1,215.9	1,275.1
Domestic loans	1,145.6	1,147.0	1,166.6	1,422.9	1,538.2
Net credit to government (NCG) (including securities)	354.0	257.5	99.1	136.8	143.2
NCG to central government (including securities)	408.7	312.4	163.0	206.9	239.5
NCG to other government (including securities)	-54.8	-54.9	-64.0	-70.1	-96.3
Loans to corporations and households (excluding securities)	791.6	889.4	1,067.5	1,286.1	1,394.9
Loans to corporations (excluding securities)	554.1	574.2	649.7	745.5	795.3
Loans to households (excluding securities)	237.5	315.2	417.8	540.6	599.6
Other net items (including securities and capital)	-201.1	-166.2	-250.8	-207.0	-263.1
Holdings of securities	16.6	18.8	14.4	13.6	14.4
Issued securities	-51.6	-74.9	-119.1	-121.8	-134.7
Liabilities					
Monetary aggregate M2	1,766.1	1,844.1	1,992.1	2,188.6	2,311.0
Monetary aggregate M1	902.8	962.3	1,087.3	1,239.8	1,338.4
Currency in circulation	221.4	236.8	263.8	295.3	309.8
Overnight deposits	681.4	725.6	823.5	944.5	1,028.6
Overnight deposits - households	372.1	410.8	456.6	529.3	586.6
Overnight deposits - corporations	309.3	314.7	367.0	415.2	442.0
M2-M1 (quasi money)	863.3	881.8	904.8	948.8	972.5
Deposits with agreed maturity	666.4	675.3	671.4	674.9	692.6
Deposits with agreed maturity - households	439.8	458.6	445.1	433.6	445.7
Deposits with agreed maturity - corporations	226.6	216.7	226.3	241.3	246.9
Deposits redeemable at notice	185.6	198.8	224.1	265.6	270.9
Deposits redeemable at notice - households	182.3	194.6	220.6	260.8	267.0
Deposits redeemable at notice - corporations	3.2	4.2	3.6	4.8	3.9
Repurchase agreements	11.3	7.6	9.3	8.4	9.0
Annual percentage changes					
M1	14.6	6.6	13.0	14.0	15.3
M2	6.9	4.4	8.0	9.9	12.1
Loans to corporations and households	9.3	12.4	20.0	20.5	21.0
M2-M1 (deposits)	-0.1	2.1	2.6	4.9	8.0
Annual percentage growth rates					
M1	15.5	8.3	13.1	14.7	15.3
M2	8.1	5.8	8.1	10.6	12.1
Loans to corporations and households	11.8	15.3	20.8	21.6	21.3
M2-M1 (deposits)	1.2	3.3	2.6	5.7	8.0

Table 7

INTEREST RATES ON INTERBANK DEPOSITS

percentages

	2003 12	2004 12	2005 12	2006 12	2007 6
1. Average PRIBOR [1]					
- 1 day	1.98	2.49	2.00	2.48	2.70
- 7 day	2.02	2.51	2.04	2.51	2.77
- 14 day	2.03	2.51	2.04	2.51	2.78
- 1 month	2.04	2.53	2.05	2.52	2.81
- 2 month	2.06	2.55	2.10	2.54	2.83
- 3 month	2.08	2.57	2.17	2.56	2.93
- 6 month	2.13	2.67	2.33	2.67	3.09
- 9 month	2.22	2.76	2.44	2.79	3.26
- 12 month	2.30	2.85	2.53	2.89	3.38
2. Average PRIBID [1]					
- 1 day	1.88	2.39	1.90	2.38	2.60
- 7 day	1.92	2.41	1.94	2.41	2.67
- 14 day	1.93	2.41	1.94	2.41	2.68
- 1 month	1.94	2.43	1.95	2.42	2.71
- 2 month	1.96	2.45	2.00	2.44	2.73
- 3 month	1.98	2.47	2.07	2.46	2.83
- 6 month	2.03	2.57	2.23	2.57	2.99
- 9 month	2.12	2.66	2.34	2.69	3.16
- 12 month	2.20	2.75	2.43	2.79	3.28

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

Table 8

FRA RATES percentages; monthly averages

	2003 12	2004 12	2005 12	2006 12	2007 6
3 * 6	2.23	2.74	2.46	2.71	3.27
3 * 9	2.36	2.81	2.57	2.83	3.42
6 * 9	2.47	2.85	2.66	2.92	3.56
6 * 12	2.64	2.92	2.74	3.02	3.67
9 * 12	2.77	2.97	2.79	3.08	3.76
9*12 - 3*6 spread	0.55	0.24	0.33	0.37	0.49
6*12 - 3*9 spread	0.28	0.12	0.17	0.19	0.25

IRS RATES percentages; monthly averages

	2003 12	2004 12	2005 12	2006 12	2007 6
1Y	2.41	2.82	2.56	2.86	3.45
2Y	2.98	3.06	2.82	3.09	3.77
3Y	3.38	3.27	3.00	3.21	3.95
4Y	3.69	3.45	3.13	3.31	4.07
5Y	3.93	3.62	3.25	3.40	4.18
6Y	4.13	3.77	3.33	3.46	4.26
7Y	4.29	3.89	3.40	3.52	4.33
8Y	4.43	4.00	3.46	3.58	4.39
9Y	4.54	4.09	3.52	3.63	4.45
10Y	4.64	4.17	3.58	3.68	4.50
15Y	4.97	4.40	3.78	3.83	4.67
20Y	5.11	4.54	3.88	3.89	4.75
5Y - 1Y spread	1.52	0.80	0.69	0.54	0.73
10Y - 1Y spread	2.23	1.35	1.02	0.82	1.05

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
1/03	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	5.9	2.0	0.8	1.2	4.1	0.3	-0.1	0.3	3.2
1/07	2.5	2.9	6.1	2.1	1.2	1.5	4.8	0.7	-0.3	0.1	3.3
2/07	2.5	2.8	6.1	2.1	1.0	1.3	4.5	0.6	-0.7	-0.4	2.8
3/07	2.5	2.8	6.0	2.1	0.6	0.9	4.1	0.2	-1.0	-0.8	2.4
4/07	2.5	2.9	6.1	2.1	0.0	0.4	3.5	-0.4	-1.1	-0.8	2.3
5/07	2.5	3.2	6.0	2.0	0.1	0.7	3.5	-0.4	-1.6	-0.9	1.8
6/07	2.8	3.4	—	—	0.3	0.9	—	—	-1.7	-1.2	—

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			
	PRIBOR		client rates		PRIBOR		client rates	
	2W	1Y	new loans	time deposits	2W	1Y	new loans	time deposits
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
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
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
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
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
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
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
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
1/05	-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
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
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
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
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
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
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
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	2.5	-1.2	-0.5	-0.1	2.8	-0.9
1/07	-0.6	-0.2	3.0	-1.0	—	—	—	—
2/07	-0.5	-0.2	3.0	-0.9	—	—	—	—
3/07	-0.7	-0.4	2.7	-1.1	-0.4	-0.1	3.0	-0.8
4/07	-0.6	-0.2	2.9	-1.0	—	—	—	—
5/07	-0.7	0.0	2.7	-1.1	—	—	—	—
6/07	-0.4	0.2	—	—	-0.5	-0.1	—	—

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

	2003 12	2004 12	2005 12	2006 12	2007 5
Koruna interest rates on loans provided by banks to residents:					
Households and non-profit institutions serving households (S.14+S.15) - total	8.24	7.96	7.20	6.80	6.62
- maturity up to 1 year	11.21	12.82	12.96	13.75	13.91
- maturity over 1 year and up to 5 years	10.17	12.40	11.43	11.35	11.35
- maturity over 5 years	6.65	6.39	5.96	5.84	5.74
for consumption - total	13.83	14.89	13.88	13.59	13.23
- maturity up to 1 year	14.26	15.48	16.22	17.31	17.18
- maturity over 1 year and up to 5 years	13.86	15.17	14.94	14.67	14.28
- maturity over 5 years	13.21	13.45	11.85	11.93	11.63
for house purchase - total	6.31	5.93	5.24	4.91	4.84
- maturity up to 1 year	6.24	4.48	4.29	5.39	6.08
- maturity over 1 year and up to 5 years	7.05	6.57	6.22	6.15	6.09
- maturity over 5 years	6.09	5.89	5.19	4.88	4.81
other - total	7.80	7.50	7.09	6.87	6.64
- maturity up to 1 year	8.49	8.96	9.09	9.52	9.71
- maturity over 1 year and up to 5 years	8.02	7.63	7.17	7.74	7.79
- maturity over 5 years	7.02	6.58	5.79	5.51	5.40
Non-financial corporations (S.11) - total	4.53	4.75	4.20	4.45	4.54
- maturity up to 1 year	4.08	4.35	3.84	4.23	4.36
- maturity over 1 year and up to 5 years	4.64	4.68	4.18	4.38	4.44
- maturity over 5 years	5.14	5.39	4.72	4.74	4.80
Koruna interest rates on deposits accepted by banks from residents:					
Households and non-profit institutions serving households (S.14+S.15) - total	1.30	1.41	1.25	1.28	1.24
overnight	0.50	0.52	0.40	0.41	0.41
with agreed maturity - total	2.02	2.13	1.92	1.96	1.91
- with agreed maturity up to 2 years	0.96	1.37	1.03	1.49	1.51
- with agreed maturity over 2 years	2.90	2.69	2.50	2.31	2.22
redeemable at notice - total	1.26	1.63	1.71	1.97	2.00
- redeemable at notice up to 3 months	1.67	2.14	2.27	2.34	2.35
- redeemable at notice over 3 months	0.98	1.12	0.81	1.00	1.01
Non-financial corporations (S.11) - total	0.85	1.21	0.91	1.18	1.13
overnight	0.64	0.68	0.52	0.72	0.65
with agreed maturity - total	1.50	2.08	1.64	2.09	2.00
- with agreed maturity up to 2 years	1.49	2.05	1.61	2.08	2.00
- with agreed maturity over 2 years	3.04	3.12	2.47	2.28	2.20
redeemable at notice - total	1.17	1.60	1.14	1.64	1.59
- redeemable at notice up to 3 months	1.14	1.49	1.07	1.53	1.47
- redeemable at notice over 3 months	1.32	2.26	1.64	2.21	2.29

Table 12

BALANCE OF PAYMENTS [1] in CZK millions

	2003 Q1 - 4	2004 Q1 - 4	2005 Q1 - 4	2006 Q1 - 4	2007 [2] Q1
A. Current account	-160,614.6	-147,455.7	-48,500.2	-100,324.9	13,385.8
Balance of trade	-69,793.0	-13,384.0	59,369.5	68,213.0	42,179.6
exports	1,370,930.0	1,722,657.4	1,868,585.8	2,144,005.5	598,647.6
imports	1,440,723.0	1,736,041.4	1,809,216.3	2,075,792.5	556,468.0
Services	13,236.7	16,564.4	36,542.0	34,572.8	5,268.6
credit	219,151.1	247,084.8	282,016.3	300,370.9	66,948.8
transport	60,556.3	69,859.0	76,701.5	84,292.7	22,786.5
travel	100,310.1	107,231.8	111,839.3	113,125.0	24,849.2
others	58,284.7	69,994.0	93,475.5	102,953.2	19,313.1
debit	205,914.4	230,520.4	245,474.3	265,798.1	61,680.2
transport	33,725.7	47,571.4	56,254.1	62,008.2	16,465.5
travel	54,419.2	58,398.0	57,777.6	60,015.4	12,756.4
others	117,769.5	124,551.0	131,442.6	143,774.5	32,458.3
Income	-119,858.4	-156,637.9	-155,700.6	-183,431.3	-30,653.6
credit	75,508.3	87,206.1	105,728.7	121,355.9	33,075.2
debit	195,366.7	243,844.0	261,429.3	304,787.2	63,728.8
Current transfers	15,800.1	6,001.8	11,288.9	-19,679.4	-3,408.8
credit	46,976.7	53,050.6	78,545.3	65,872.5	25,871.8
debit	31,176.6	47,048.8	67,256.4	85,551.9	29,280.6
B. Capital account	-82.2	-14,186.5	4,689.3	8,467.0	2,622.1
credit	198.2	5,608.2	5,525.2	14,269.5	2,909.1
debit	280.4	19,794.7	835.9	5,802.5	287.0
Total A + B	*-160,696.8*	*-161,642.2*	*-43,810.9*	*-91,857.9*	*16,007.9*
C. Financial account	157,093.5	177,312.0	154,767.4	111,611.3	-14,466.9
Direct investment	53,500.3	101,776.3	279,630.5	104,307.1	26,277.5
abroad	-5,815.7	-26,067.3	449.0	-30,370.0	-3,990.4
equity capital and reinvested earnings	-3,124.6	-20,260.0	-4,262.8	-29,228.4	-3,016.9
other capital	-2,691.1	-5,807.3	4,711.8	-1,141.6	-973.5
in the Czech Republic	59,316.0	127,843.6	279,181.5	134,677.1	30,267.9
equity capital and reinvested earnings	59,350.4	121,482.9	262,471.8	117,628.4	42,412.4
other capital	-34.4	6,360.7	16,709.7	17,048.7	-12,144.5
Portfolio investment	-35,719.1	53,032.5	-81,243.8	-26,882.5	-19,648.5
assets	-83,892.7	-70,245.2	-82,095.7	-68,383.5	-17,263.6
equity securities	5,630.5	-36,457.1	-35,342.4	-43,559.2	-16,696.7
debt securities	-89,523.2	-33,788.1	-46,753.3	-24,824.3	-566.9
liabilities	48,173.6	123,277.7	851.9	41,501.0	-2,384.9
equity securities	30,133.5	19,558.6	-36,408.9	5,758.0	-1,437.3
debt securities	18,040.1	103,719.1	37,260.8	35,743.0	-947.6
Financial derivatives	3,860.1	-3,208.0	-2,798.6	-6,323.5	3,963.5
assets	7,083.7	-15,565.8	-2,860.9	-10,899.8	6,532.6
liabilities	-3,223.6	12,357.8	62.3	4,576.3	-2,569.1
Other investment	135,452.2	25,711.2	-40,820.7	40,510.2	-25,059.4
assets	67,071.3	-30,507.4	-114,430.6	-35,522.5	-39,356.1
long-term	1,141.3	20,434.2	-16,338.0	-6,060.0	-6,229.4
CNB	—	-184.9	-176.3	—	2.3
commercial banks	-999.9	505.0	-24,641.7	-10,715.5	-5,604.2
government	5,714.3	22,790.7	14,056.5	4,983.6	-656.2
other sectors	-3,573.1	-2,676.6	-5,576.5	-328.1	28.7
short-term	65,930.0	-50,941.6	-98,092.6	-29,462.5	-33,126.7
commercial banks	44,971.2	-34,248.5	-87,137.0	24,770.1	-21,632.9
government	2,193.8	92.9	9.4	—	—
other sectors	18,765.0	-16,786.0	-10,965.0	-54,232.6	-11,493.8
liabilities	68,380.9	56,218.6	73,609.9	76,032.7	14,296.7
long-term	26,361.6	36,550.9	49,022.1	51,095.2	12,253.4
CNB	-20.4	-20.5	-19.1	-18.1	-9.1
commercial banks	-5,038.0	-1,410.8	311.1	12,733.4	9,570.2
government	10,304.7	10,296.1	20,809.1	9,550.3	-716.9
other sectors	21,115.3	27,686.1	27,921.0	28,829.6	3,409.2
short-term	42,019.3	19,667.7	24,587.8	24,937.5	2,043.3
CNB	-21.4	843.7	5,060.1	-4,147.6	-1,188.1
commercial banks	37,899.4	-15,344.5	14,808.8	2,369.2	-1,775.6
government	—	—	—	—	—
other sectors	4,141.3	34,168.5	4,718.9	26,715.9	5,007.0
Total A + B + C	*-3,603.3*	*15,669.8*	*110,956.5*	*19,753.4*	*1,541.0*
D. Net errors and omissions, valuation changes	16,506.7	-8,887.6	-18,104.9	-17,679.0	-729.2
Total A + B + C + D	*12,903.4*	*6,782.2*	*92,851.6*	*2,074.4*	*811.8*
E. Change in reserves (- increase)	-12,903.4	-6,782.2	-92,851.6	-2,074.4	-811.8

1) Balance of payments structure based on the Balance of Payments Manual (5th edition), IMF 1993
2) Preliminary data

Table 13

INTERNATIONAL INVESTMENT POSITION in CZK millions

	2003 31 Dec.	2004 31 Dec.	2005 31 Dec.	2006 31 Dec.	2007[1] 31 Mar.
Assets	1,537,284.6	1,549,333.7	1,875,403.8	1,894,747.4	1,994,185.6
Direct investment abroad	58,581.5	84,087.4	88,772.7	105,600.0	111,775.0
- equity capital	50,965.5	70,664.0	80,061.1	96,510.0	101,530.0
- other capital	7,616.0	13,423.4	8,711.6	9,090.0	10,245.0
Portfolio investment	343,968.7	372,237.6	467,808.5	531,990.4	577,790.0
- equity securities	47,337.7	76,121.3	146,957.6	202,122.7	229,447.7
- debt securities	296,631.0	296,116.3	320,850.9	329,867.7	348,342.3
Financial derivatives	24,129.5	39,695.3	42,556.2	53,456.0	46,884.0
Other investment	419,090.0	417,071.9	549,564.4	547,063.3	590,598.7
long-term	157,598.6	118,432.7	136,314.1	129,684.5	136,193.1
- CNB	468.4	600.0	3,184.5	2,993.8	3,027.7
- commercial banks	66,121.3	58,137.8	83,231.1	87,666.1	94,055.5
- government	79,483.9	48,574.9	38,408.5	29,894.6	30,014.9
- other sectors	11,525.0	11,120.0	11,490.0	9,130.0	9,095.0
short-term	261,491.4	298,639.2	413,250.3	417,378.8	454,405.6
- CNB	98.8	71.7	71.1	131.3	79.4
- commercial banks	161,150.2	184,588.0	273,879.1	233,927.5	257,376.2
of which: gold and foreign exchange	115,884.8	128,119.8	198,042.8	166,580.8	141,733.4
- government	102.4	9.5	0.1	0.0	0.0
- other sectors	100,140.0	113,970.0	139,300.0	183,320.0	196,950.0
CNB reserves	691,514.9	636,241.5	726,702.0	656,637.7	667,137.9
- gold	4,784.3	4,253.9	5,526.8	5,690.9	6,035.6
- SDR	238.7	118.0	289.8	346.0	367.2
- reserve position in the IMF	11,949.9	9,137.5	4,447.7	2,324.6	1,988.0
- foreign exchange	674,451.8	622,606.4	716,315.2	648,192.1	658,697.6
- other reserve assets	90.2	125.7	122.5	84.1	49.5
Liabilities	2,064,768.3	2,374,328.4	2,710,646.3	2,928,764.2	2,989,411.9
Direct investment in the Czech Republic	1,161,783.6	1,280,594.8	1,491,564.0	1,617,053.0	1,648,970.4
- equity capital	1,009,391.8	1,121,842.3	1,316,101.8	1,433,723.0	1,476,135.4
- other capital	152,391.8	158,752.5	175,462.2	183,330.0	172,835.0
Portfolio investment	223,620.4	381,019.4	437,806.0	487,994.5	497,971.9
- equity securities	140,788.6	208,872.1	220,495.8	241,594.8	241,410.4
- debt securities	82,831.8	172,147.3	217,310.2	246,399.7	256,561.5
Financial derivatives	19,448.3	31,806.1	31,868.4	36,444.7	33,912.9
Other investment	659,916.0	680,908.1	749,407.9	787,272.0	808,556.7
long-term	360,279.2	373,456.4	417,645.7	448,883.2	465,167.4
- CNB	96.1	70.2	47.8	27.2	18.1
- commercial banks	58,056.3	52,020.8	51,639.8	62,263.6	72,330.4
- government	22,456.0	32,065.4	52,322.1	61,236.4	60,622.9
- other sectors	279,670.8	289,300.0	313,636.0	325,356.0	332,196.0
short-term	299,636.8	307,451.7	331,762.2	338,388.8	343,389.3
- CNB	22.8	866.5	5,926.5	1,779.0	590.9
- commercial banks	208,534.0	185,025.2	201,315.7	193,934.8	193,623.4
- government	—	—	—	—	—
- other sectors	91,080.0	121,560.0	124,520.0	142,675.0	149,175.0
Net investment position	-527,483.7	-824,994.7	-835,242.5	-1,034,016.8	-995,226.3

1) Preliminary data

Table 14

EXTERNAL DEBT					in CZK millions
	2003 31 Dec.	2004 31 Dec.	2005 31 Dec.	2006 31 Dec.	2007[1] 31 Mar.
Debt in convertible currencies	895,139.6	1,011,807.9	1,142,180.3	1,217,001.7	1,237,953.2
of which:					
Long-term	535,995.9	667,327.6	783,533.1	844,844.5	865,500.2
by debtor					
- CNB	96.1	70.2	47.8	27.2	18.1
- commercial banks	73,276.4	64,346.5	65,418.9	76,426.6	86,582.8
- government	69,029.9	147,729.1	221,003.4	246,569.8	253,880.5
- other sectors	393,593.5	455,181.8	497,063.0	521,820.9	525,018.8
by creditor					
- foreign banks	251,535.3	269,081.3	276,594.3	304,855.9	320,623.0
- government institutions	—	—	9,636.0	9,555.5	8,686.0
- multilateral institutions	83,779.6	84,862.4	105,187.7	109,106.6	106,695.6
- suppliers and direct investors	109,287.9	143,301.2	170,586.6	170,625.0	169,710.0
- other investors	91,393.1	170,082.7	221,528.5	250,701.5	259,785.6
Short-term	359,143.7	344,480.3	358,647.2	372,157.2	372,453.0
by debtor					
- CNB	22.8	866.5	5,926.5	1,779.0	590.9
- commercial banks	210,017.0	188,495.9	202,616.9	196,648.2	196,793.3
- government	710.0	3,334.6	1,102.4	350.0	710.0
- other sectors	148,393.9	151,783.3	149,001.4	173,380.0	174,358.8
by creditor					
- foreign banks	218,436.1	202,372.6	197,820.7	192,668.8	191,240.2
- multilateral institutions	—	861.3	5,918.8	1,768.2	581.6
- suppliers and direct investors	105,563.9	98,611.3	102,235.6	123,495.0	121,485.0
- other investors	35,143.7	42,635.1	52,672.1	54,225.2	59,146.2
Debt in non-convertible currencies	—	—	—	—	—
of which:					
- long-term	—	—	—	—	—
- short-term	—	—	—	—	—
Total external debt	895,139.6	1,011,807.9	1,142,180.3	1,217,001.7	1,237,953.2
of which:					
- long-term	535,995.9	667,327.6	783,533.1	844,844.5	865,500.2
- short-term	359,143.7	344,480.3	358,647.2	372,157.2	372,453.0
Total long-term debt	535,995.9	667,327.6	783,533.1	844,844.5	865,500.2
of which:					
- IMF loans	—	—	—	—	—
- liabilities of government sector and guaranteed by government, and liabilities of entities majority owned by state	222,120.9	272,202.1	322,498.4	338,187.3	344,008.6
- liabilities of entities with majority private capital	313,875.0	395,125.5	461,034.7	506,657.2	521,491.6

1) Preliminary data

Table 15

EXCHANGE RATES

in CZK; foreign exchange market rates

A. NOMINAL RATE	2003 1 - 12	2004 1 - 12	2005 1 - 12	2006 1 - 12	2007 4 - 6
CZK exchange rate against selected currencies					
- annual/quarterly averages					
1 EUR	31.84	31.90	29.78	28.34	28.27
1 USD	28.23	25.70	23.95	22.61	20.97
100 SKK	76.75	79.69	77.15	76.16	83.77
	12	**12**	**12**	**12**	**6**
- monthly averages					
1 EUR	32.31	30.65	28.98	27.78	28.55
1 USD	26.32	22.87	24.44	21.02	21.27
100 SKK	78.57	78.81	76.51	79.44	83.96
	31 Dec.	**31 Dec.**	**30 Dec.**	**29 Dec.**	**29 Jun.**
- last day of the month					
1 EUR	32.41	30.47	29.01	27.50	28.72
1 USD	25.65	22.37	24.59	20.88	21.26
100 SKK	78.71	78.63	76.57	79.86	85.36

B. NOMINAL EFFECTIVE RATE	2003	2004	2005	2006	2007 6
CZK nominal effective exchange rate (percentages)					
(2005=100)					
weights - foreign trade turnover	94.0	94.3	100.0	104.6	103.7
weights - foreign trade turnover SITC 5-8	93.8	94.2	100.0	105.0	104.0

Drawing on CZSO statistics on the geographical and commodity structure of foreign trade for 2005, 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	2003	2004	2005	2006	2007 5
CZK real effective exchange rate (percentages)					
(2005=100)					
a) industrial producer prices					
weights - foreign trade turnover	93.1	95.8	100.0	102.0	102.6
weights - foreign trade turnover SITC 5-8	92.6	95.5	100.0	102.3	103.1
b) consumer prices					
weights - foreign trade turnover	95.4	95.3	100.0	104.3	104.8
weights - foreign trade turnover SITC 5-8	94.7	94.9	100.0	104.7	105.5

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
	2003 1 - 12	2004 1 - 12	2005 1 - 12	2006 1 - 12	2007 1 - 6
STATE BUDGET					
Total revenue	699.7	769.2	866.5	923.1	483.3
Tax revenue	667.5	716.7	770.4	801.6	422.4
Taxes on income, profits and capital gains	172.9	180.7	195.0	187.1	100.1
Domestic taxes on goods and services	198.4	223.2	250.4	266.1	136.2
- value-added taxes	125.6	140.4	146.8	153.5	80.2
- excises	72.9	82.8	103.6	112.6	56.0
Taxes on property	8.8	10.4	8.1	8.5	4.9
Social and health security contributions and payroll taxes	272.4	293.3	311.2	333.7	177.1
Non-tax and capital incomes and received subsidies	32.2	52.5	96.1	121.5	61.0
Total expenditure	808.7	862.9	922.8	1,020.6	482.0
Current expenditure	745.4	796.8	840.8	912.1	453.9
Capital expenditure	63.3	66.1	82.0	108.5	28.1
Public budgets (balance in IMF GFS methodology)	-127.7	-89.4	0.6	-148.9	__
state budget	-104.9	-65.0	-61.1	-107.0	1.3
local budget	-2.9	-8.9	7.8	-3.9	__
state financial assets	__	__	__	__	__
state funds	6.9	-11.7	-0.5	-6.6	__
Land Fund	-0.1	0.2	1.6	0.2	__
National Property Fund	-27.4	-4.2	51.5	-29.9	__
health insurance companies	0.1	0.2	0.5	0.6	__
others	0.6	0.0	0.8	-2.3	__

Table 17

CAPITAL MARKET

last day of the month in points

A. STOCK MARKET INDICES	2003 12	2004 12	2005 12	2006 12	2007 6
BCPP					
PX	659.1	1,032.0	1,473.0	1,588.9	1,859.1
PX-GLOB	816.9	1,232.7	1,811.3	1,987.4	2,310.2
RM-SYSTÉM					
PK-30	947.5	1,443.5	2,365.0	2,595.3	3,057.2

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	2003 12	2004 12	2005 12	2006 12	2007 6
BCPP					
Monthly trade volumes	98,640.0	90,610.5	96,160.5	112,400.0	126,995.7
of which:					
a) shares	28,296.0	46,210.3	56,180.3	58,915.7	69,834.5
b) bonds	70,344.0	44,400.2	39,980.2	53,484.3	57,161.2
RM-SYSTÉM					
Monthly trade volumes	1,103.0	335.8	286.7	523.0	447.8
of which:					
a) shares	1,082.5	332.7	220.9	440.2	447.3
b) units	3.7	3.1	0.0	1.1	0.5
c) bonds	16.8	0.0	65.8	81.7	0.0

Table 18

CNB MONETARY POLICY INSTRUMENTS

	2W repo rate (%)	Discount rate (%)	Lombard rate (%)	Minimum reserve requirement for primary deposits (%)	
				Banks	Building societies and ČMZRB
1999					
18 January	8.75	—	—	—	—
28 January	—	—	—	5.00	—
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	—	—
2007					
1 June	2.75	1.75	3.75	—	—

Table 19

MACROECONOMIC AGGREGATES

in CZK millions; annual percentage changes; constant 2000 prices

	2003 Q1 - 4	2004 Q1 - 4	2005 Q1 - 4	2006 Q1 - 4	2007 Q1
Gross domestic product					
- in CZK millions	2,367,818	2,476,074	2,636,842	2,850,199	695,455
- percentages	3.6	4.6	6.5	6.4	6.1
Final consumption					
- in CZK millions	1,817,625	1,837,528	1,882,101	1,945,651	471,235
- percentages	6.3	1.1	2.4	3.4	4.7
of which:					
Households					
- in CZK millions	1,258,158	1,295,066	1,326,419	1,384,675	338,381
- percentages	6.0	2.9	2.4	4.4	6.7
Government					
- in CZK millions	545,999	528,962	541,201	547,292	129,542
- percentages	7.1	-3.1	2.3	1.1	0.4
Non-profit institutions					
- in CZK millions	13,362	14,579	15,563	16,249	4,267
- percentages	6.2	9.1	6.7	4.4	6.6
Gross capital formation					
- in CZK millions	709,600	773,884	772,398	863,074	217,142
- percentages	-1.4	9.1	-0.2	11.7	13.4
of which:					
Fixed capital					
- in CZK millions	689,117	716,285	732,585	788,278	177,971
- percentages	0.4	3.9	2.3	7.6	1.5
Changes in inventories					
- in CZK millions	15,642	54,674	37,078	71,707	38,331
Acquisitions less disposals of valuables					
- in CZK millions	4,841	2,925	2,735	3,089	840
- percentages	40.8	-39.6	-6.5	12.9	8.6
Foreign trade					
of which:					
Exports of goods					
- in CZK millions	1,479,795	1,820,657	2,033,180	2,377,490	663,979
- percentages	9.3	23.0	11.7	16.9	16.7
Exports of services					
- in CZK millions	212,807	225,335	254,244	277,344	61,095
- percentages	-4.2	5.9	12.8	9.1	-1.3
Imports of goods					
- in CZK millions	1,623,393	1,929,219	2,028,041	2,343,682	639,661
- percentages	9.0	18.8	5.1	15.6	17.9
Imports of services					
- in CZK millions	235,915	263,075	273,590	308,721	73,437
- percentages	1.8	11.5	4.0	12.8	5.1
Final domestic demand					
- in CZK millions	2,506,742	2,553,813	2,614,686	2,733,929	649,206
- percentages	4.6	1.9	2.4	4.6	3.8
Aggregate domestic demand					
- in CZK millions	2,527,225	2,611,412	2,654,499	2,808,725	688,377
- percentages	4.0	3.3	1.6	5.8	7.3
Gross domestic product at current prices					
- in CZK millions	2,577,110	2,817,362	2,994,396	3,220,259	816,070
- percentages	4.6	9.3	6.3	7.5	9.9

Source: CZSO

Table 20

LABOUR MARKET

annual percentage changes

A. NATIONAL ACCOUNTS FOR THE HOUSEHOLD SECTOR	2003 Q1 - 4	2004 Q1 - 4	2005 Q1 - 4	2006 Q1 - 4	2007 Q1
Current income	5.9	4.9	4.4	6.4	8.4
of which:					
- gross operating surplus and mixed income	7.7	5.7	-0.8	2.7	9.1
- compensation of employees	5.5	5.7	6.2	6.7	8.7
- property income	5.3	-1.0	1.2	15.4	2.3
- social benefits other than social transfers in kind	3.6	3.4	4.7	8.6	7.0
- other current transfers	10.9	2.2	7.9	3.6	13.6
Current expenditure	9.5	7.5	4.5	7.7	8.9
of which:					
- property income	21.3	12.4	-5.4	40.7	23.8
- current taxes on income, wealth, etc.	12.1	7.7	0.7	0.8	6.8
- social contributions	7.2	8.3	6.5	8.9	8.6
- other current transfers	12.5	2.8	2.5	5.1	8.9
Gross disposable income	4.3	3.6	4.3	5.8	8.2
Change in net equity of households in pension funds reserves	15.4	29.1	11.1	19.6	-6.0
Individual consumption expenditure	6.5	5.6	3.3	6.0	7.7
Gross saving	-15.5	-17.8	23.0	6.2	9.6
Gross saving rate	8.03	5.89	6.57	6.60	10.98
(gross saving/gross disposable income - ratio in per cent)					

annual percentage changes

B. AVERAGE WAGES	2003 Q1 - 4	2004 Q1 - 4	2005 Q1 - 4	2006 Q1 - 4	2007 Q1
Whole-economy nominal wage	6.4	6.2	5.3	6.4	8.1
Business sector	5.5	6.3	5.3	6.7	8.6
Non-business sector	9.8	5.7	5.7	5.4	6.1
Whole-economy real wage	6.3	3.3	3.3	3.8	6.5
Business sector	5.4	3.4	3.3	4.1	7.0
Non-business sector	9.7	2.8	3.7	2.8	4.5

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	2003 12	2004 12	2005 12	2006 12	2007 6
Registered job applicants (thousands)	542.4	541.7	510.4	448.5	370.8
Unemployment rate (percentages) 1)	—	9.5	8.9	7.7	6.3

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

Source: CZSO

Table 21

PRODUCER PRICES

percentage changes

	2003	2004	2005	2006	2007 6
Industrial producer prices					
a) previous period = 100	0.1	0.6	0.0	0.2	0.7
b) same period of previous year = 100	-0.3	5.7	3.0	1.6	4.6
c) average for 2005 = 100	-8.2	-3.0	0.0	1.5	6.1
Construction work prices					
a) previous period = 100	0.2	0.4	0.2	0.3	0.5
b) same period of previous year = 100	2.2	3.7	3.0	2.9	3.6
c) average for 2005 = 100	-6.1	-2.6	0.2	3.1	6.7
Agricultural producer prices					
a) previous period = 100	0.6	0.2	-0.4	0.7	1.7
b) same period of previous year = 100	-2.9	8.1	-9.2	1.1	9.1
c) average for 2005 = 100	2.1	10.4	0.0	1.1	13.2
Market services prices					
a) previous period = 100	0.0	0.2	0.1	0.3	-0.4
b) same period of previous year = 100	1.6	2.3	1.9	3.3	1.5
c) average of 2005 = 100	-1.9	0.4	0.0	3.3	5.3

Source: CZSO

Table 22

RATIOS OF KEY INDICATORS TO GDP					percentage ratios
	2002	2003	2004	2005	2006
Public budgets balance	-0.5	-5.0	-3.2	0.0	-4.6
Public debt	18.0	21.5	23.4	25.5	27.3
Debt in convertible currencies	33.0	34.7	35.9	38.1	37.8
Trade balance [1]	-2.9	-2.7	-0.5	2.0	2.1
Current account balance	-5.5	-6.2	-5.2	-1.6	-3.1
M2	67.0	68.5	65.5	66.5	68.0

Note: ratio = indicator/GDP at current prices
1) CZSO source in FOB values

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