# INFLATION REPORT / I

2008

CNB CZECH NATIONAL BANK

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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.

This year sees several changes in monetary policy decision-making and communication. First, the CNB has changed the frequency of the Bank Board's regular monetary policy meetings from monthly to eight meetings a year, a fact also reflected in the inflation report publication schedule. Another major change is that the CNB will publish the forecast-consistent interest rate path in numerical form, as a fan chart. Starting this year, the CNB will also publish the votes cast by the board members on interest rate settings by name in the minutes of the Bank Board meetings, which are also available as a standard part of the Inflation Reports. As a result of these changes, and in an effort to bring the structure of the Inflation Report more into line with the logic of the forecasting process at the CNB, the sections of the Inflation Report have been reorganised as well.

Section II of the Inflation Report now describes economic and monetary developments in the previous quarter, which represent the starting conditions for the forecast for the Czech economy. Section III describes the forecast for the Czech economy as drawn up 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 credible as possible. The Czech National Bank is convinced that credible 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 forecast and the balance of risks and uncertainties surrounding it. The arrival of new information since the forecast was drawn up and the possibility of asymmetric assessment of the risks of the forecast and divergent views of some board members on the development of the external environment or the linkages between the various indicators within the Czech economy mean that the Bank Board's final decision need not always correspond entirely to the message of the forecast. Information on the Bank Board's discussions over the past three months and on the reasons for its monetary policy measures in that period is given in the minutes of the Bank Board meetings at the end of this Inflation Report.

The annex to this Inflation Report is a document analysing the current and expected fulfilment of the Maastricht criteria and the degree of economic alignment of the Czech Republic with the euro area. Based on these analyses, the document recommends that the Czech Republic should not set a target date for euro area entry and therefore should not to attempt to enter the ERM II during 2008. The document was drawn up by the Ministry of Finance of the Czech Republic and the Czech National Bank, and was approved by the Government of the Czech Republic on 19 December 2007.

This Inflation Report was approved by the CNB Bank Board on 14 February 2008 and contains the information available as of 25 January 2008.

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 in the text of this Inflation Report are published at the same internet address.

**Chart I.1 Fulfilment of the inflation target**
**Inflation was above the upper boundary of the inflation-target tolerance band in 2007 Q4**
(annual percentage changes)


*Inflation increased in 2007 Q4 and was above the upper boundary of the inflation-target tolerance band (see Chart I.1). The rise in consumer price inflation was largely due to food prices and regulated prices. The real economy also had a modest inflationary effect. At the end of November, in line with the October forecast, the Bank Board raised monetary policy rates by 0.25 percentage point. The current forecast assumes a rise in inflation at the beginning of 2008. Starting from Q2 inflation will decrease, however. Consistent with the macroeconomic forecast and its assumptions is a modest rise in nominal interest rates initially, followed by a decline still in 2008. At its February meeting the Bank Board assessed the risks of the forecast as being high and heading in both directions, and in line with the forecast it decided by a majority vote to increase the monetary policy interest rates by 0.25 percentage point.*

The monetary policy decision-making of the CNB Bank Board in 2007 Q4 was based on the inflation forecast described in the October Inflation Report. Given the monetary policy transmission lag, the Board focused on hitting the inflation target at the end of 2008 and the start of 2009. According to the forecast, inflation in this period should initially lie above the upper boundary of the inflation-target tolerance band and then fall below the target. Monetary-policy relevant inflation should be slightly above the inflation target at the monetary policy horizon. Consistent with the baseline scenario of the macroeconomic forecast and its assumptions was growth in nominal interest rates.

At its meetings in 2007 Q4, the Bank Board decided to increase monetary policy interest rates only once, by 0.25 percentage point with effect from 30 November. This decision was consistent with the macroeconomic forecast. The Bank Board assessed the overall risks of the forecast in this period as being slightly inflationary, with the major upside and downside risks to inflation all being significant. Accelerating food price inflation and a higher outlook for energy prices were expected to have an inflationary effect. Conversely, a significantly stronger exchange rate and an outlook of somewhat slower economic growth abroad were expected to have anti-inflationary effects.

The November increase in monetary policy interest rates generated a rise in money market interest rates. Faster growth was recorded by rates at shorter maturities. By contrast, rates with maturities of over one year were flat due to the situation on foreign markets.

**Table I.1 Key macroeconomic indicators**
**The koruna's exchange rate appreciated against both the euro and the dollar in 2007 Q4**
(annual percentage changes unless otherwise indicated)

| | 9/07 | 10/07 | 11/07 | 12/07 |
|---|---|---|---|---|
| Consumer price inflation | 2.8 | 4.0 | 5.0 | 5.4 |
| Industrial producer price inflation | 4.0 | 4.4 | 5.4 | 5.3 |
| Money supply growth (M2) | 11.0 | 10.6 | 11.3 | - |
| 3M PRIBOR [a], (in per cent) | 3.5 | 3.6 | 3.7 | 4.1 |
| CZK/EUR exchange rate [a], (level) | 27.57 | 27.34 | 26.73 | 26.30 |
| CZK/USD exchange rate [a], (level) | 19.87 | 19.22 | 18.21 | 18.04 |
| State budget balance since January [b], (CZK bn) | 36.3 | 27.2 | 12.8 | -66.4 |
| GDP growth at constant prices [c] | 6.0 | | | - |
| Unemployment rate [d], (in per cent) | 6.2 | 5.8 | 5.6 | 6.0 |

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

The rising interest rates and a downward revision of market expectations regarding euro area rates going forward led to a further closing of the negative interest rate differential. The increasing attractiveness of the koruna for investors, together with the release of favourable foreign trade figures, caused the koruna to appreciate in 2007 Q4 (see Table I.1).

Monetary policy operated in an environment of a slightly inflationary real economy. This was due in part to continued buoyant growth of the Czech economy, which, despite slowing somewhat in 2007 Q3, still exceeded its potential. The GDP growth was due in almost equal measure to household consumption and gross capital formation. The contribution of net exports was far lower. The effect of government consumption on Czech economic growth was slightly negative.

The continued buoyant growth of the Czech economy created the right conditions for rising employment. Annual employment growth accelerated further in 2007 Q3, despite a growing shortage of workers in the required occupations. The rising employment and dynamic job creation led to a sizeable decrease in the unemployment rate. In this situation, annual wage growth remained relatively high at roughly the previous quarter's level. However, wages grew at a broadly equilibrium rate and had an almost neutral effect on inflation.

In addition to the slightly inflationary real economy, the sharp rise in inflation in 2007 Q4 was due to food prices and regulated prices. The impact of the high prices of energy-producing materials on world markets on inflation was partly dampened by the koruna's appreciation against the dollar. In Q4, inflation was above the October forecast level.

Section III of this Inflation Report describes the CNB's new forecast, which takes into account new information obtained since the October forecast was drawn up as well as a change in the modelling system.

New data on domestic economic activity, inflation and the labour market confirm that the real economy is inflationary. However, the real marginal cost gap, which captures the inflation pressures from the real economy, will narrow quickly and turn anti-inflationary as the year progresses. This effect will be maintained in 2009. Its components – the output gap and the real wage gap – will act in opposite directions over most of the forecast period. The output gap will quickly turn negative and remain anti-inflationary next year, whereas the real wage gap will turn from anti-inflationary to inflationary in 2009. GDP growth will slow this year and accelerate moderately again in 2009.

Inflation will continue to rise sharply at the start of 2008, but will decline steadily from 2008 Q2 onwards. The temporary effect of high food and regulated prices and indirect tax changes will then unwind in 2009, when inflation will fall significantly. Compared to the October forecast, the forecast for headline inflation is much higher in 2008, but lower from the start of 2009. The effect of the unexpectedly high inflation outturns at the end of 2007 and the increased forecast for regulated prices will prevail at the start of the forecast horizon. After the base effect associated with these factors drops out, the effect of lower forecasts for adjusted inflation excluding fuels and food price inflation will manifest itself, as a result of a stronger exchange rate, a more anti-inflationary real economy and changes to the model. Inflation will thus fall towards the inflation target in 2009, and conditions will be created for hitting the new inflation target in 2010 (2%). At the monetary policy horizon, i.e. at the end of 2008 and in 2009 H1, headline inflation will initially lie slightly above the upper boundary of the inflation-target tolerance band and then drop slightly below the target (see Chart I.2).

The first-round effects of indirect tax changes, to which the mechanism of escape clauses applies as usual, on annual inflation are now only small at the monetary policy horizon. At the monetary policy horizon, monetary-policy relevant inflation drops below the inflation target and approaches the new 2% inflation target (see Chart I.3). Consistent with the macroeconomic forecast and its assumptions is a modest rise in nominal interest rates initially, followed by a decline still in 2008. In 2009, nominal interest rates are expected to be broadly flat (see Chart I.4).

The baseline scenario of the forecast shows the most probable path of the economy from the CNB's point of view. A relatively high degree of uncertainty is currently perceived regarding the modelling of the price-formation process. This risk is covered by an alternative scenario which returns to the model settings corresponding to the October forecast and assumes, among other things, that headline inflation immediately affects price formation in all price categories. In the alternative scenario, administrative effects and other price shocks lead to a higher headline inflation path. At the monetary policy horizon, headline inflation initially lies above the upper boundary of the inflation-target tolerance band and then drops towards the target. Monetary-policy relevant inflation is also higher at the monetary policy horizon than in the baseline scenario. The interest rate path consistent with the alternative scenario of the forecast is higher overall than in the baseline scenario.

**Chart I.2 The headline inflation forecast**

**At the monetary policy horizon, the inflation forecast initially lies slightly above the upper boundary of the inflation-target tolerance band and then drops slightly below the target**

(annual percentage changes)

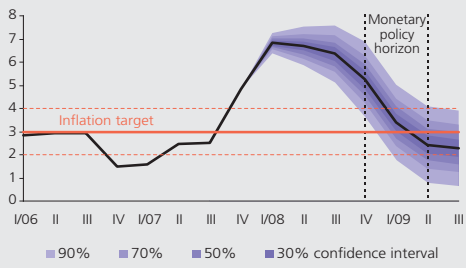



**Chart I.3 The monetary-policy relevant inflation forecast**

**At the monetary policy horizon, monetary-policy relevant inflation drops below the inflation target and approaches the new 2 per cent target**

(annual percentage changes)

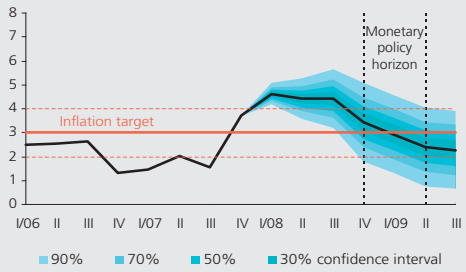
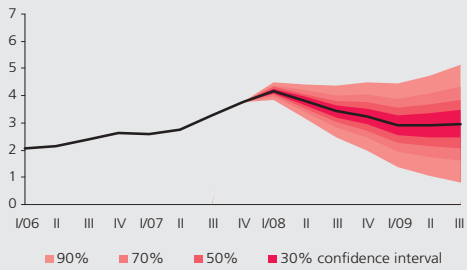



**Chart I.4 The interest rate forecast**

**Consistent with the macroeconomic forecast and its assumptions is a modest rise in nominal interest rates initially, followed by a decline still in 2008**

(3M PRIBOR, %)



At its February meeting the Bank Board assessed the risks of the baseline scenario of the forecast as being high and heading in both directions. The main upside risk to inflation, according to the Bank Board, was a higher effect of cost shocks on prices in other price categories and on inflation expectations (the alternative scenario of the forecast). The downside risks included the currently stronger exchange rate of the koruna, a possible faster unwinding of the growth in food prices, and weaker-than-forecasted economic growth in the USA and in the Czech Republic's other major trading partner countries. In line with the forecast, the Bank Board decided at this meeting by a majority vote to increase the monetary policy rates by 0.25 percentage point, effective 8 February 2008.

The annex to this Inflation Report is the full version of the *Assessment of the Fulfilment of the Maastricht Convergence Criteria and the Degree of Economic Alignment of the Czech Republic with the Euro Area*. This document, which the CNB was involved in preparing, was approved by the Government of the Czech Republic on 19 December 2007. The aim of the document is to inform the Government about the current and expected fulfilment of the Maastricht criteria and the degree of alignment of the Czech economy with the euro area economy. In line with *The Czech Republic's Updated Euro-area Accession Strategy* (see the Annex to the October 2007 Inflation Report), this document is submitted to the Government every year. The latest assessment resulted in a recommendation not to set a target date for euro area entry and therefore not to attempt to enter the ERM II during 2008.

**BOX 1**
**Changes in the conduct and communication of monetary policy**

Starting from 2008, the conduct and communication of monetary policy will undergo some changes. The main aim of these changes is to further increase the transparency, clarity and predictability of monetary policy.

The outlook for the Czech economy described in this Report discloses the forecast-consistent interest rate path in numerical form for the first time. To emphasise the uncertainty of the forecast for this and other variables, the outlook for key variables is illustrated using fan charts. More information about the reasons for publishing the interest rate path and about the construction of fan charts can be found in Box 2 *Publication of the forecast-consistent interest rate path and the use of fan charts*.

The disclosure of the votes cast by the board members on interest rate changes by name in the minutes of Bank Board meetings will also contribute significantly to transparency. Knowledge of the votes cast by name will enable the public to better identify the opinions of each board member and thus better understand the decisions of the Board as a whole. The board members will have more freedom to express their views in public. Increasing the board members' individual accountability for their own voting will enhance the principle of majority decision-making at board level. This collective decision-making will continue to reflect the natural diversity of the board members' expert opinions on economic and monetary developments.

Another change consists in a reduction of the number of regular monetary policy meetings to eight a year. Bank Board meetings will usually be held on the first Thursday in February, May, August and November and on the last Thursday in March, June, September and December. The publication schedule for related documents, including the Inflation Report, has been changed

accordingly. The Inflation Report will be approved on the second Thursday and published on the second Friday in February, May, August and November. The reason for reducing the number of meetings is that the Czech economy has stabilised in recent years. Consequently, there is no need for such frequent changes in interest rates as in the early years of inflation targeting.

**BOX 2**
**Publication of the forecast-consistent interest rate path and the use of fan charts**

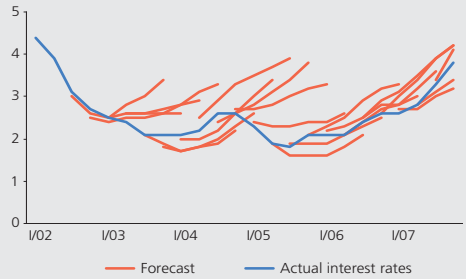
Starting from 2008, instead of providing a verbal description of the expected interest rate path the CNB will publish its interest rate forecast in numerical form, as a fan chart. This box explains the conditional nature of the rate forecast and the methodology for the construction of fan charts.

By releasing its interest rate forecast the CNB is continuing to enhance its monetary policy transparency. If the public can better comprehend the central bank's actions and assess the quality of its analyses and forecasts, its trust in the bank's ability to keep inflation on target increases. It is vital, however, that all users of the central bank's forecasts are aware that the published forecast-consistent interest rate path should in no way be interpreted as a commitment of the central bank to set interest rates in line with the forecast. There are two reasons for this. First, the forecast represents the most probable future path of interest rates under given initial assumptions and information. New information on the domestic and global economy that comes in after the forecast is drawn up can change the interest rate outlook. The second reason is that the CNB Bank Board may not entirely agree with the forecast prepared by the Monetary and Statistics Department or may regard the associated risks as being skewed to one side or the other. Chart 1 shows that interest rates have often deviated from the forecasts in the past as well. The chart illustrates all the projected interest rate paths from individual consecutive forecasts as well as the actual interest rate path since 2002. The interest rate shown is the three-month money market rate (3M PRIBOR), which is used in the CNB's forecasting system to proxy for the CNB's key monetary policy rate, i.e. the two-week repo rate.

To emphasise uncertainty, or the conditional nature of the forecast, the CNB has started using fan charts. Starting with this Inflation Report, fan charts are used to illustrate the uncertainty surrounding not only the interest rate forecasts, but also the outlook for headline inflation, monetary-policy relevant inflation and GDP growth. The central line in each chart represents the baseline scenario of the forecast, and the bands around this line illustrate the uncertainty surrounding the forecast. The successively lighter bands represent widening confidence limits. The darkest band around the centre shows the development which can occur with 30% probability, while the other bands successively show the developments occurring with 50%, 70% and 90% probability.

The confidence intervals are constructed with reference to the errors of previous CNB forecasts for the relevant variables. The advantage of this approach is its simplicity and clarity and the fact that it captures all the types of uncertainty contributing to the non-fulfilment of the forecasts (the

CHART 1 (BOX) INTEREST RATE FORECASTS
**The actual interest rate path often differs from the CNB forecasts**
(3M PRIBOR, in %)



uncertainty regarding input assumptions as well as the settings of forecasting instruments). A potential disadvantage is that in the event of changing conditions and economic shock strengths the past prediction errors may not precisely capture the size of the uncertainty going forward. The confidence intervals should thus be regarded as only tentative.

When creating the confidence intervals in fan charts, we assume a symmetric normal distribution around the baseline scenario of the forecast. The variance of this normal distribution is based on the Root Mean Square Error (RMSE). The RMSE for a given forecast horizon is defined as follows:

$$RMSE = \sqrt{\frac{1}{8}\sum_{j=1}^{8}(X_j - F_j)^2}$$

where *X* is the actual value of the forecast variable, *F* is the forecast for this variable drawn up in the past with a corresponding forecast horizon, and the difference *(X - F)* is the forecast error. The RMSE is calculated from the errors of the last eight available forecasts, fulfilment of which can be assessed at the eight-quarter horizon. The RMSE for the individual forecast horizons is then further smoothed linearly so that the probability fan has a smooth shape. The RMSE is updated once a year. The confidence intervals are derived for the individual horizons and confidence levels from the relevant (smoothed) RMSE and the relevant quantiles of the normal distribution.

The confidence interval for the interest rate and GDP growth paths widens linearly over the entire forecast horizon, whereas that for headline and monetary-policy relevant inflation widens only for the first four quarters and then remains constant. This is consistent with the evolution of the CNB's forecast errors to date and generally also with the inflation targeting regime, under which the central bank anchors inflation close to the target at the medium-term horizon, whereas the interest rate and GDP paths reflect the effects of unforeseen shocks faced by monetary policy.

## II.1 THE EXTERNAL ENVIRONMENT

*Economic growth increased to just below 3% in 2007 Q3 in both the USA and the euro area. Slovak GDP growth picked up further. Slovakia was the fastest growing country in the Central European region, while Hungary was the slowest. Faster growth in energy and food prices resulted in generally rising consumer price inflation in 2007 Q4. The US dollar depreciated against the euro from USD 1.42 to 1.46 in this period, nearing the 1.50 level. In Q4, the average price of Brent crude oil was almost USD 89/barrel, increasing by 18% compared to the previous quarter.*

Annual economic growth in the USA picked up markedly in 2007 Q3 following the weaker growth recorded in 2007 H1, and reached 2.8%. Household consumption growth remained strong, the fall in fixed investment moderated and net exports improved. The outlook for 2008 worsened, however. Retail sales decreased by 0.4% year on year in December, and the unemployment rate, whose average level in Q4 rose by 0.4 percentage point year on year, increased from 4.7% in November to 5% in December. The number of new jobs decreased as well, with virtually no jobs created in December. The housing market crisis deepened further. The number of mortgage defaults increased, while house prices and the number of housing starts both declined. The problems in the financial markets saw no improvement either.

Average annual inflation increased to 4% in Q4, from 3.4% in Q3, largely because of faster growth in prices of oil, other commodities and food. The higher headline inflation had yet to show up in second-round effects, as indicated by still low growth in core inflation and flat inflation expectations. The Fed reacted to the sub-prime mortgage crisis and the subsequent turmoil in the financial markets by lowering its key rate by 0.5 percentage point to 4.75% in mid-September. It cut the key rate further at the end of October and again in December, each time by another 0.25 percentage point to 4.25%. At an extraordinary meeting on 22 January, the FOMC decreased the key rate by 0.75 percentage point to 3.5%, the biggest rate change since 1982. This step was taken in an effort to prevent the deepening financial market crisis from impacting on the US economy.

Annual GDP growth in the euro area was 2.7% in 2007 Q3. This increase of 0.2 percentage point compared to the previous quarter was due to all components of domestic demand and also to net exports. Business and consumer confidence indicators have been falling gradually for several months, suggesting a slowdown in economic growth in 2007 Q4. Lower growth in industrial production and retail sales in the first two months of 2007 Q4 also suggest a modest slowdown. The labour market situation improved further thanks to the buoyant economic growth. The unemployment rate remained unchanged month on month in December, but decreased by 0.6 percentage point to 7.2% in year-on-year comparison.

Annual inflation was 3.1% in December, the same as in November, owing to rapid growth in energy and food prices. Core inflation remains below the 2% level, suggesting that the second-round effects of the rapid rise in inflation have yet to materialise. Inflation expectations also remained anchored close to the ECB's inflation target. The money supply grew quickly: M3 rose by 11.5% year on year in December, while loans to the private sector were up by 11.1%. The turmoil in the financial markets, therefore, does not appear to have had any significant effect on money and credit aggregates so far. According to the ECB, the high growth in both aggregates signals a risk to price stability in the medium and longer term.

The ECB raised its rates by 0.25 percentage point two times in 2007 (in March and June) and its key rate thus increased to 4%. The bank made no further rate changes in 2007, despite rising inflation and strong GDP and monetary aggregate growth. The main reason was the financial market turbulence, which introduced

**CHART II.1 THE DOLLAR-EURO EXCHANGE RATE**
**The dollar-euro exchange rate twice neared USD 1.50/EUR in 2007 Q4 and in January 2008**

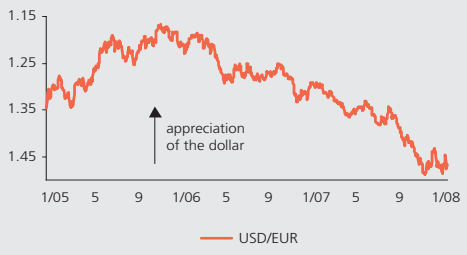



**CHART II.2 BRENT AND URAL CRUDE OIL PRICES**
**The price of Brent crude oil repeatedly broke through USD 95 a barrel in 2007 Q4 and in January 2008**
(USD/barrel)

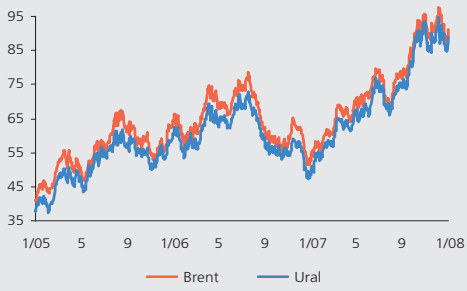
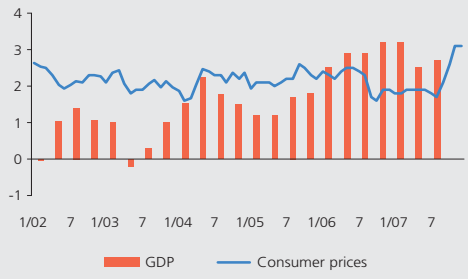



**CHART II.3 GDP AND INFLATION IN THE EURO AREA**
**Inflation in the euro area rose sharply at the end of 2007**
(annual percentage changes)



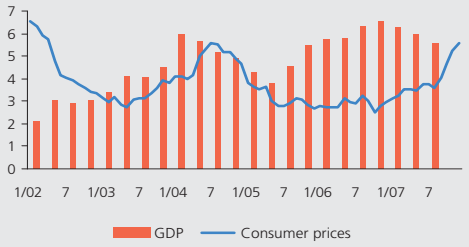
uncertainty into the economic growth outlook in the direction of a larger-than-expected slowdown.

The relatively strong economic growth in Germany continued into 2007 Q3. As in Q2, GDP grew by 2.5% year on year. Despite flat consumer demand, robust export growth led to high growth in industrial production and investment. Economic growth probably slackened in Q4, due to high oil prices, the strong euro and worse financing conditions. This is indicated by declines in retail sales, industrial production growth and the Ifo and ZEW confidence indices. Thanks to the buoyant economic growth in previous quarters, however, the unemployment rate decreased significantly year on year, falling by 1.5 percentage point in Q4 compared to a year earlier. As in the euro area as a whole, inflation in Germany exceeded the 2% level in September due to a jump in energy prices. One month later food prices started accelerating, and in November, together with energy prices, pushed headline inflation up to 3.1%. In December, the growth in energy prices moderated and headline inflation fell to 2.8%.

**Chart II.4 GDP and inflation in the new EU Member States**

**Consumer price inflation in the 12 new EU Member States increased sharply in 2007 Q4**

(annual percentage changes)



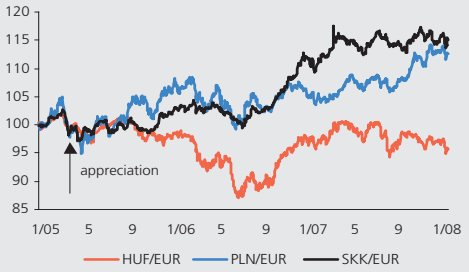

In the Central European region, inflation increased at the end of 2007 as a result of the rising energy and food prices. Economic growth in Hungary weakened further and this country remained the slowest growing economy in the region.

In Slovakia, the very strong economic growth continued into 2007 Q3, chiefly thanks to high growth in consumption and investment. Its rate of increase was 0.5 percentage point higher than in Q2, reaching 9.7%. This led to a further month-on-month and year-on-year reduction in the unemployment rate, to 11%. Inflation (CPI) rose by 0.3 percentage point to 3.4% owing to higher growth in prices of fuels, food and imputed rents. The 12-month harmonised inflation rate (HICP) fell to 1.9% in December, well below the Maastricht inflation criterion (currently at 2.8%). This accession requirement is also expected to be safely met in spring 2008, when Slovakia's preparedness to enter the euro area will be assessed. The NBS left its key rate unchanged in Q4 at 4.25%, where it has been since April 2007.

**Chart II.5 Central European currencies**

**Among the currencies of the Central European region, the Polish zloty showed the strongest year-on-year appreciation in 2007 Q4 and in January 2008**

(average for January 2005 = 100)




In Poland, annual GDP growth decreased from 6.6% to 5.8% in Q3. Growth in consumption and particularly investment (more than 20%) was still very strong, but net exports deteriorated. The robust economic growth continued into Q4. In November, industrial production increased by more than 8% year on year, retail sales rose by more than 13%, unemployment decreased by almost 4 percentage points year on year and employment grew by 5%. The high labour demand also explains the rate of wage growth in the corporate sector, which exceeded 12% in November. This growth rate decreased to 7% in December, but this fall was solely due to the transfer of bonuses to the following year. Annual inflation rose by 0.4 percentage point to 4% in December. The main factors behind this rise were food and regulated prices, but inflation picked up in almost all price categories. The NBP raised its key rate four times in 2007, each time by 0.25 percentage point (from 4% to 5% overall). The last increase was made at the November meeting of the Monetary Policy Council.

Annual GDP growth in Hungary decreased from 1.6% in 2007 Q2 to 1.1% in Q3 amid a decline in all domestic demand components and in export growth. Industrial production growth slowed in the first two months of 2007 Q4 and retail trade turnover declined further in October. The unemployment rate in December was unchanged in month-on-month comparison and virtually unchanged even in year-on-year terms, remaining at 7.3%. Annual inflation rose by a further 0.4 percentage point to 7.4% in December, mainly because of high growth in fuel and food prices. The MNB left its key rate unchanged throughout Q4. The last change was made at the end of September, when the bank lowered the rate by 0.25 percentage point to 7.5%. Analysts expect further cuts only when it becomes certain that the current high inflation will not feed through to a rise

in inflation expectations and wages. According to preliminary estimates, the 2007 public finance deficit will amount to about 5.6% of GDP.

## II.2 THE MONETARY CONDITIONS

*According to the CNB's calculations, the settings of the real monetary conditions in 2007 Q4 can be characterised as neutral to slightly easy. The interest rate component was assessed as being slightly easy, whereas the exchange rate component was slightly tight. The evolution of the two components of the monetary conditions in 2007 Q4 is described in more detail below.*

### II.2.1 Interest rates

Interest rates showed mixed developments in 2007 Q4 depending on maturity. Money market interest rates continued to rise steadily, whereas rates with longer maturities (over 1 year) were generally flat. The rates were affected above all by a 0.25 percentage point increase in the CNB's key rates. With effect from 30 November 2007, the 2W repo rate was 3.5%, the Lombard rate 4.5% and the discount rate 2.5%. Although this increase had been expected by most financial market participants, and despite an appreciating koruna, money market rates still rose slightly, especially in the case of 1M–2M maturities. The cause was increased nervousness and demand for liquidity on European money markets, associated, among other things, with the year-end effect; foreign entities were also attempting to finance through eurokorunas. At the beginning of 2008 this factor abated to some extent. The increase in rates was also due to rising inflation. Financial market participants were therefore expecting the CNB to tighten monetary policy further.

Money market interest rates rose by 0.3–0.6 percentage point overall in 2007 Q4. Rates with maturities of over one year increased much less or were flat, owing to the situation on foreign markets, where investors remained risk averse. PRIBOR spot quotations and FRA forward quotations at the end of 2007 indicated that financial market participants expected a further monetary policy tightening at the CNB Bank Board's February meeting.

The PRIBOR yield curve gradually shifted upwards during 2007 Q4, and its slope remained positive. The spread between the 1Y PRIBOR and the 2W PRIBOR was 0.57 percentage point in December. The IRS yield curve recorded a more marked increase at its short end than at its longer end. Nonetheless, the slope of the curve remained slightly positive. In December, the average 5Y–1Y spread was 0.11 percentage point and the 10Y–1Y spread 0.33 percentage point.

The interest rate differential on the money market (PRIBID/CZK-EURIBOR/EUR or EURIBOR/USD) was affected by changes in key rates and by movements in interbank money market rates. The ECB left its refinancing operations rate unchanged at 4.00% during Q4, while the Fed lowered its key O/N rate in two steps by 0.50 percentage point to 4.25%. In January, the Fed cut the O/N rate by a further 0.75 percentage point to 3.50%. Overall, the negative interest rate differentials vis-à-vis euro rates narrowed and those vis-à-vis dollar rates even became positive.

Five auctions were held on the primary government bond market, with a total volume of CZK 30.6 billion. Besides the standard maturities, the first-ever 50Y bond was issued. The interest in such a long-term bond was relatively low, owing to expected lower liquidity. Demand in the other auctions was higher. The bonds that were not underwritten were purchased by the Czech Ministry of Finance into its portfolio.

CHART II.6 THE CNB'S KEY RATES
**The CNB raised its key interest rates**
(percentages)

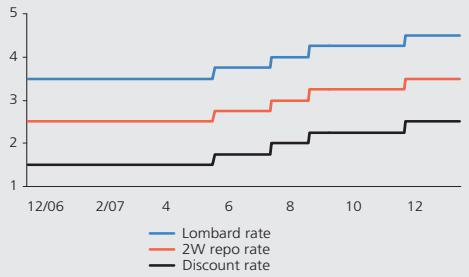



CHART II.7 MARKET INTEREST RATES
**Money market interest rates rose in Q4**
(percentages)

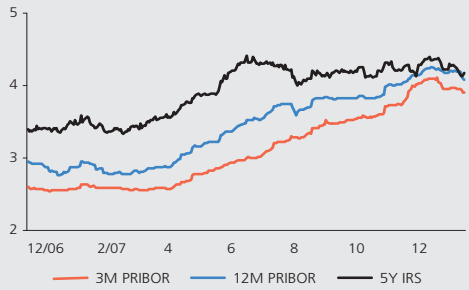



CHART II.8 INTEREST RATE DIFFERENTIALS
**Interest rate differentials vis-à-vis the dollar turned positive**
(percentage points)

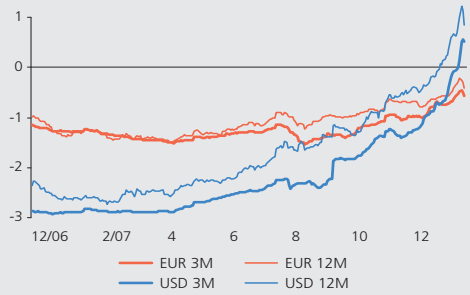


Chart II.9 Ex ante real rates

**Ex ante real interest rates on new loans increased**

(percentages)

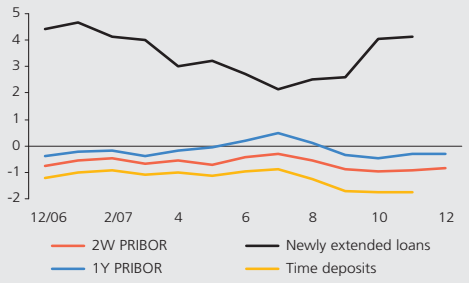



Chart II.10 CZK/EUR and CZK/USD exchange rates

**The koruna appreciated against the euro and the dollar in 2007 Q4**

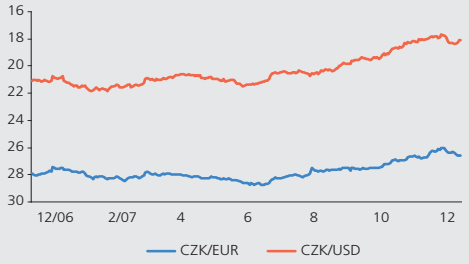
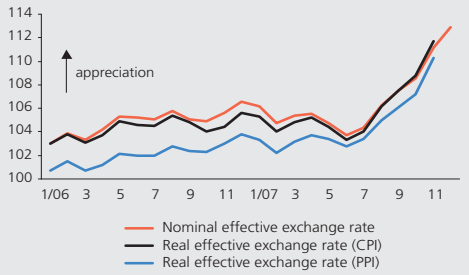



Chart II.11 Effective exchange rates of the koruna

**The nominal and real effective exchange rates appreciated year on year in 2007 Q4**

(year 2005 = 100)




Nominal interest rates on new loans were 6.8% and rates on new time deposits 2.5% in November. Real interest rates[1] are affected not only by the level of nominal rates, but also by movements in inflation expectations. Consumer price inflation expectations increased slightly during 2007 Q4, whereas expected industrial producer price inflation declined. Real rates on new loans were 4.1% in November, while real rates on time deposits were -1.8%.

### II.2.2 The exchange rate

The average exchange rate of the koruna against the euro in 2007 Q4 was CZK 26.8/EUR (see Chart II.10), which represents a year-on-year appreciation of 4.3%. It also strengthened in quarter-on-quarter terms – by 3.9%. The koruna's year-on-year appreciation trend observed since mid-2003 (which moderated significantly to 0.4% in 2007 Q2 due to carry trades) thus accelerated again at the end of 2007. This acceleration was due to a combination of several factors that mostly caused the koruna to firm. The most important of the fundamental factors was a continuing year-on-year improvement in the output balance, bolstered by a one-off major financial transaction that increased the supply of foreign currency on the market. Another important factor was a narrowing of the koruna's negative interest rate differential vis-à-vis the euro, resulting from the CNB's monetary policy rate increase in November and from financial market expectations of a further narrowing in 2008. The last significant factor affecting the exchange rate of the koruna was the continuing financial market turbulence, which led short-term investors to shift their funds from risky – primarily dollar – assets to more secure ones (including, marginally, the Czech koruna).

In mid-December, however, the koruna recorded quite a sharp depreciation, probably due to the closing of short-term koruna positions by non-residents before the year-end. The koruna weakened from CZK 26.0/EUR to CZK 26.6/EUR. However, these positions appeared to be reopened in early January. The koruna's appreciation was also fostered by information of relatively high consumer price inflation in December and a relatively high trade surplus in November (which the markets interpreted as increasing the probability of a rate increase at the start of 2008). In January, the exchange rate fluctuated around CZK 26/EUR, representing a year-on-year appreciation of about 6.4%. The key factor underlying the evolution of the exchange rate and its relatively large fluctuations was short-term capital movements, reflecting increasing uncertainty on the part of short-term financial investors as regards how to allocate their assets.

In 2007 Q4, the average exchange rate of the koruna against the dollar was CZK 18.5/USD, which represents year-on-year appreciation of 14.9% and quarter-on-quarter appreciation of 8.9%. The dollar's gradual depreciation trend against the majority of convertible currencies has been evident since 2001 and is linked primarily with the deep external imbalance of the US economy. Since July 2007, this trend has been exacerbated by bad news from the USA signalling the risk of a sharp slowdown in US economic growth in 2008. This risk has already led the Fed to lower interest rates. The evolution of the interest rate differential between the dollar and other major world currencies (the euro in particular) in 2007 H2, coupled with negative expectations regarding future economic growth in the USA and further cuts in US rates, caused the dollar to fall sharply on global financial markets.

1 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.

The dollar continued depreciating in early 2008 following more bad news from the financial sector and the labour market and due to persisting problems with the external imbalance. In January, the average exchange rate was CZK 17.7/USD, representing a year-on-year appreciation of the koruna against the dollar of more than 17%.

The appreciation of the koruna's nominal effective exchange rate accelerated further in 2007 Q4. The nominal effective exchange rate firmed by 4.9% year on year in Q4 (6% in December), thus strengthening its previous trend (see Chart II.11). The year-on-year appreciation was largely due to the koruna's appreciation against the euro and the dollar. In Q4, the year-on-year appreciation of the real effective exchange rate was even more pronounced than that of the nominal rate, as a result of both producer and consumer prices rising faster at home than abroad. In October and November, the PPI-deflated real effective exchange rate firmed by 5.9% and the CPI-deflated real effective exchange rate by 5.7% year on year.

## II.3 DEMAND AND OUTPUT

*Economic growth continued to slacken in 2007 Q3, but remained high. At 6%, GDP growth was only slightly below the October forecast. As expected, the growth was driven mainly by domestic demand; its contribution to output growth was affected chiefly by household consumption expenditure, which was supported above all by buoyant growth in households' disposable income. The contribution of gross fixed capital was also significant. Its continuing rapid growth was in line with the current phase of the business cycle. Although real exports continued to rise strongly, the contribution of net exports to output growth remained low. Imports continued to rise fast and were significantly affected by the rise in exports and the robust domestic demand. According to the CNB's calculations, the output of the economy still exceeded the potential, non-accelerating inflation level of output. This assumption was supported by survey evidence of high production capacity utilisation in industry and labour shortages in some branches, amid higher demand for labour.*

### II.3.1 Domestic demand

Domestic demand growth slowed in 2007 Q3, with all its main components contributing to the slowdown. Household final consumption expenditure, which is the main component of domestic demand, moderated to 5.6% year on year; its contribution to GDP growth exceeded 40%. Following a very modest increase in 2007 Q2, government final consumption expenditure saw a year-on-year decline in Q3. By comparison with Q2, growth in gross fixed capital formation also fell (to 5.7%). Its contribution to GDP growth was about one-fifth. The contribution of additions to inventories to GDP growth was slightly lower than that of fixed investment.

#### *Consumption*

Although annual household consumption growth moderated further in 2007 Q3, it was still high (5.6%; see Chart II.14). This was in line with a decline in the CZSO's consumer confidence index in Q2 and Q3, which in September converged significantly towards the levels observed at the beginning of 2005, as shown in Chart II.15.

Unlike in the previous quarter, the slowdown in consumption expenditure growth in 2007 Q3 was due not to households' disposable income, but to increased saving:

CHART II.12 GROSS DOMESTIC PRODUCT
**The rate of economic growth eased further in 2007 Q3**
(annual percentage changes)

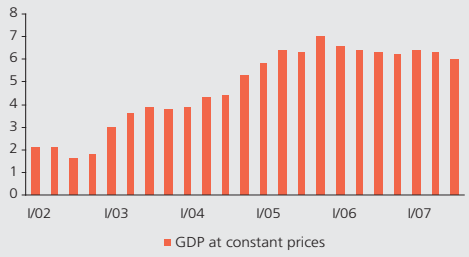



CHART II.13 STRUCTURE OF GDP GROWTH
**Economic growth continued to be driven by domestic demand in 2007 Q3**
(contributions in percentage points; annual percentage changes)

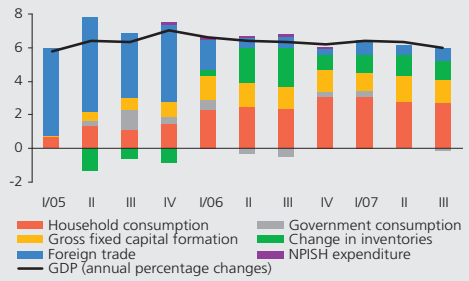
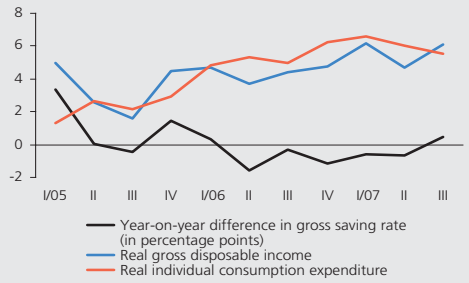



CHART II.14 HOUSEHOLD CONSUMPTION EXPENDITURE
**Household consumption growth eased in 2007 Q3, but remained high**
(annual percentage changes)

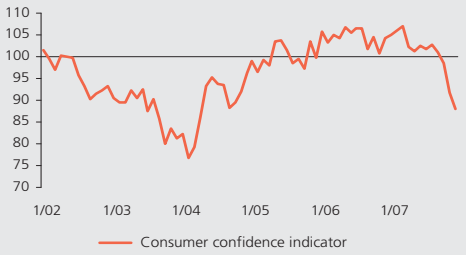


the gross saving rate rose by 0.3 percentage point to 4.4%. Household income kept rising rapidly, reflecting above all the continuing robust economic growth. Annual growth in households' disposable income increased by 1.5 percentage points compared to Q2 to 8.8% in nominal terms and rose to 5.6% in real terms. The buoyant household income growth was due chiefly to its largest component – wages and salaries – which rose by 8.3%. It was also significantly affected by social benefits, which were up by a strong 15.9%. Some households continued to finance their consumption expenditure from credit, which again recorded high year-on-year growth in Q3 (for details see section II.6 *Monetary developments*).

**Chart II.15 Consumer confidence**

**Developments in the consumer confidence index in 2007 Q4 indicated a change in the consumption behaviour of households**

(2005 average = 100)




Although household final consumption expenditure continued to grow strongly in Q3, driven mainly by the buoyant income growth, household consumption is set to weaken in the near future according to surveys conducted in 2007 Q4. In October, the consumer confidence index fell below the average level observed in 2005, owing to an expected deterioration in the overall economic situation and in households' financial situation (see Chart II.15). This turnaround was probably also due to intensive media coverage of the planned reform measures and increases in the prices of important consumer items and their expected impact on households' nominal and real income.

Government consumption decreased by 0.4% year on year in 2007 Q3. This figure suggests that the impact of non-investment government demand on total demand was neutral to slightly negative, as in the previous quarter. However, a more detailed analysis of government consumption based on the evolution of the state budget (which accounts for the bulk of the government sector as a whole) reveals a noticeable rise in public sector pay growth and other current government expenditure in nominal terms.

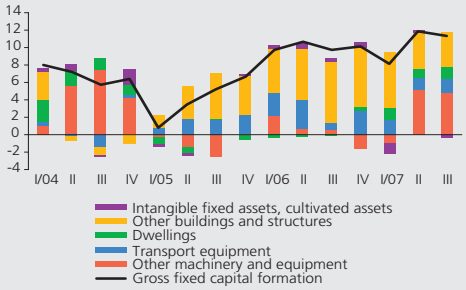
### *Investment*

According to CZSO estimates, investment demand in 2007 Q3 maintained the strong rate of growth observed with minor fluctuations since the beginning of 2006. At 5.7%, annual growth in gross fixed capital formation was only slightly below the CNB's October forecast. This result was due mainly to property development projects, public investment (channelled chiefly into transport infrastructure) and corporate investment in machinery and transport equipment.

**Chart II.16 Gross fixed capital formation**

**Investment demand showed continuing strong growth in 2007 Q3**

(annual changes in CZK billions; constant 2000 prices)




From a sectoral perspective, non-financial corporations probably contributed most to the rapid investment growth in Q3,[2] accounting for roughly two-thirds of the total investment. Within this sector, investment in machinery and equipment was probably particularly high, with the previous moderate year-on-year decline being replaced by growth of more than 7% in Q2 and Q3. Non-financial corporations also contributed to investment in transport equipment and buildings, primarily through development projects implemented by foreign investors (construction of production facilities and multifunctional centres). The assumption of continued investment in the non-financial corporations sector was supported by an undiminished inflow of FDI (including reinvested earnings) in tangible goods and by the favourable results of the CZSO's survey of producer confidence in industry.

The rapid investment growth in Q3 was also aided by investment in dwellings, mainly reflecting household demand for housing. Following a long-running decline in 2005 and 2006, caused noticeably by problems with building completions,

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

growth in investment in dwellings rebounded in 2007, reaching high levels (6.2% in Q3). As shown in Chart II.17, this went hand in hand with a double-digit surge in housing completions. This turnaround was probably due not only to the mild winter in late 2006 and early 2007, but also to the increase in tax rates on construction work as from 2008.

### II.3.2 Net external demand

Foreign trade turnover continued to expand very rapidly in 2007 Q3. However, the contribution of net exports to economic growth remained low (0.8 percentage point; see Chart II.13). The main reason for its low level, observed since the beginning of 2006, was continuing high growth in aggregate demand, linked with a strong increase in total imports.

In 2007 Q3, net exports were favourably affected by a trade surplus, following the deficit recorded in the previous quarter. The services balance also gradually improved. The improvement in the trade balance was due chiefly to strong real annual growth in goods exports, which continued to reach double figures (15.2%) despite the year-on-year appreciation of the koruna. The continuing strong export performance of the Czech economy was mainly a result of further favourable changes on the supply side (supported above all by foreign capital)[3] and buoyant external demand. Services exports have also been gradually accelerating since the beginning of 2007, thanks mainly to rising income from transport services; service exports rose by nearly 12% year on year in Q3 alone.

However, rapidly rising goods imports (14.7%), linked closely with the continued robust growth in exports and aggregate domestic demand, acted against a more significant moderation in the overall net exports deficit. These factors contributed to rapid growth in all categories of imports by use, in particular investment imports. The rise in total imports was also fostered by double-digit growth in services imports, which were significantly affected by higher travel expenditure.

### II.3.3 Output

On the supply side of the economy, annual growth in gross value added at constant prices moderated further to 5.7% in 2007 Q3. Evidence from surveys, labour market developments and other indicators suggested that the strong economic growth was still going on in an environment where actual output was above the potential, non-accelerating inflation level of output. Production capacity utilisation in manufacturing was just below 90% in Q3 (see Chart II.20). On the labour market the gap between demand and supply in some occupations widened. In the October survey, labour shortages were cited as the most significant barrier to growth in production in industry, and the importance of this factor is rising over time. A similar trend was recorded in construction, where labour shortages were reflected mainly in a pick-up in the number of buildings under construction. However, the barrier to output growth in the shape of material and equipment shortages has diminished since 2007 H2.

Gross value added growth in Q3 was driven primarily by market services and manufacturing (see Chart II.21). The contribution of construction was very low owing to extraordinary factors in Q3.[4] In agriculture and the electricity, gas and

CHART II.17 INVESTMENT IN DWELLINGS
**Investment in dwellings and housing completions have been rising since 2006 Q4**
(annual percentage changes)

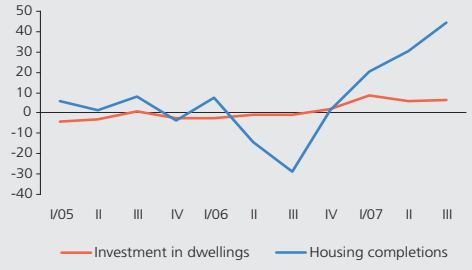



CHART II.18 NET EXTERNAL DEMAND
**The net exports deficit decreased only slightly in 2007 Q3 in year-on-year terms**
(CZK billions; constant 2000 prices)

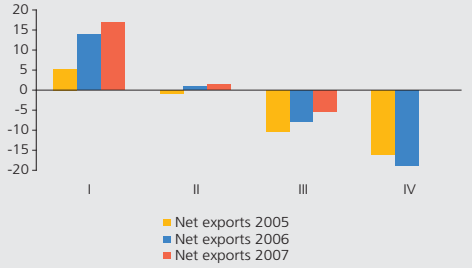
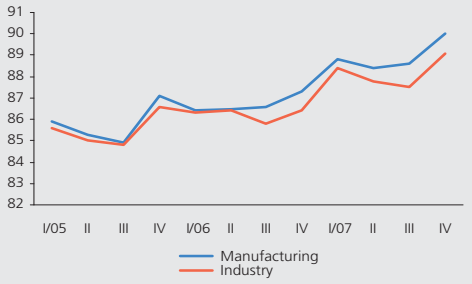



CHART II.19 EXPORTS AND IMPORTS
**Exports rose faster than imports in 2007 Q3**
(annual percentage changes; constant prices)


CHART II.20 PRODUCTION CAPACITY UTILISATION
**The rapid economic growth was achieved amid high production capacity utilisation**
(full capacity utilisation = 100)




3 Foreign-owned companies accounted for almost 75% of direct exports in industry in 2007 Q3.
4 For details see section II.4.2 *Wages and productivity.*

**Chart II.21 Contributions of branches to GDP growth**

**Services were again the biggest contributor to the high economic growth in 2007 Q3**

(contributions in percentage points; constant 2000 prices)

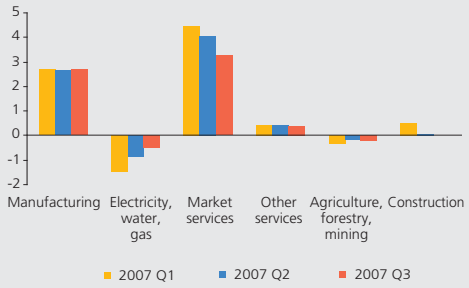



**Chart II.22 Confidence indicators**

**The confidence indicator in industry was again high in 2007 Q3**

(2005 average = 100)

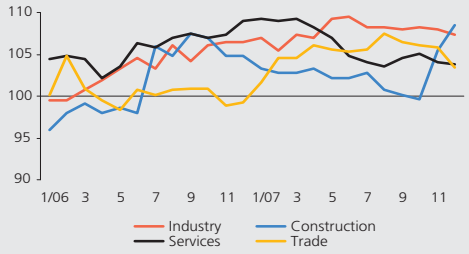



**Table II.1 Key financial indicators**

**The rapid growth in book value added continued into 2007 Q3**

(CZK billions; annual percentage changes)

| | Q3 | | Annual changes | |
|---|---|---|---|---|
| | 2006 | 2007 | CZK billions | % |
| Output excl. profit margin [a] | 1,134.1 | 1,247.3 | 113.2 | 10.0 |
| Intermediate consumption | 816.2 | 896.1 | 79.9 | 9.8 |
| Sales, total | 1,461.0 | 1,604.0 | 143.0 | 9.8 |
| Personnel costs [a] | 163.4 | 181.8 | 18.4 | 11.3 |
| Book value added | 317.9 | 351.2 | 33.3 | 10.5 |

a) CNB calculation

**Table II.2 Performance ratios**

**The personnel cost-output ratio increased in 2007 Q3, but the material cost-output ratio fell for the second consecutive quarter**

(percentages; annual changes in percentage points)

| | Q3 | | Change in p. p. against 2006 Q3 |
|---|---|---|---|
| | 2006 | 2007 | |
| Personnel cost-output ratio [a] | 14.4 | 14.6 | 0.2 |
| Material cost-output ratio [a] | 72.0 | 71.8 | -0.2 |
| Ratio of personnel costs to value added [a] | 51.4 | 51.8 | 0.4 |
| | CZK thousands per month | | Annual perc. changes |
| Book value added per employee | 55.6 | 59.8 | 7.6 |

a) CNB calculation

water supply industry, the year-on-year decline in gross value added observed in previous quarters continued.

Within market services, the largest volumes of value added and the largest contributions to value added growth were generated in trade and in real estate and business services. A continuing pick-up in value added growth was visible in this sector, although the value added growth in trade moderated further, owing probably to the decrease in household consumption growth. In both these sectors, however, value added rose faster in the first three quarters of 2007 than in 2006. According to the latest consumer, trade and services confidence surveys, output and value added growth in market services can be expected to moderate further in the near future (see Chart II.22).

In manufacturing, the growth in Q3 (of 9.8%) was supported by a rise in value added in most branches. According to CZSO statistics on book value added in individual branches,[5] its rapid growth was driven mainly by manufacture of transport equipment. Strong value added growth was also recorded in manufacture of electrical and optical equipment, manufacture of metals and fabricated metal products, manufacture and repair of machinery and equipment and manufacture of rubber and plastic products. The main factors underlying these favourable results were investment in new production and assembly lines (supported above all by foreign capital) and favourable demand. According to the latest surveys conducted in Q4, the confidence indicators in industry were broadly unchanged compared to the previous quarter, especially as regards demand and production. Only the short-term views regarding the economic situation are slightly less optimistic.

### II.3.4 Economic results of non-financial corporations[6]

According to the available data and the CNB's calculations, the favourable trends in the main indicators of the performance of non-financial corporations recorded in previous quarters continued into 2007 Q3. The annual growth of book value added declined slightly, but was still in double figures (10.5%). This growth was achieved amid a rise in output of 10%. The available data permit an estimate of continuing rapid growth in gross operating surplus of just below 10% and favourable trends in the main financial ratios.

In 2007 Q3, profit generation was again significantly affected by prices of energy-producing and raw materials, especially those of foreign origin. Renewed growth in the prices of imported energy-producing materials (particularly oil), persisting high growth in prices of energy (especially electricity) and higher prices of imported food and agricultural commodities and domestic agricultural producer prices drove up producer costs. By contrast, weakening growth in prices of imported non-energy-producing materials and falling prices of imported intermediate goods helped reduce producer costs. The pass-through of these factors to the costs of individual producers was mixed. According to the CNB's calculations, the combination of these factors resulted in a slight annual decline in the material cost-output ratio (of 0.2 percentage point; see Table II.2), which, however, was slightly lower than in the previous quarter.

5 According to data on book value added in monitored non-financial corporations with 50 employees or more at current prices.

6 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.

On the other hand, the personnel cost-output ratio increased by 0.2 percentage point year on year in 2007 Q3 following similar growth in 2007 Q1. This change in trend after a sustained period of annual decline can be attributed in part to the current labour market situation, as analysed in detail in section II.4 *The labour market*. The increase in the personnel cost-output ratio was also probably due to specific developments in wage and output variables in some branches (electricity, gas and water supply, construction, etc.). From the point of view of profit generation, the rise in the personnel cost-output ratio was offset by the falling material cost-output ratio.

Significant volumes of book value added continued to be generated in foreign-owned corporations (50%). The annual rate of growth of value added again reached double figures in these corporations in Q3, unlike in public corporations and private domestic corporations.

## II.4 THE LABOUR MARKET

*In 2007 Q3, the labour market saw continuing growth in labour demand amid still buoyant economic growth. Favourable demand and ongoing structural changes in the economy fostered rising employment in industry and services. The labour market developments also indicated growing labour shortages in some sectors, as is typical of an economy with a positive output gap. The inflow of labour from abroad provided only a partial solution to this problem. The increasing employment and high creation of vacancies generated a further significant decline in the unemployment rate, which was cyclical in nature. The relatively high proportion of long-term unemployment persisted, mainly reflecting a problem with the occupational and skills structure of the unemployed. Growth in nominal unit wage costs picked up, suggesting an upward tendency in wage-inflationary pressures compared to the previous period.*

### II.4.1 Employment and unemployment

The long-running growth in employment observed since the end of 2004 continued into 2007 Q3 (see Chart II.23). According to the CZSO, the number of employed people rose by 2.1% and total employment reached its highest level since mid-1997. In line with the ongoing structural changes in the economy the rise was due mainly to industry and services, while employment in agriculture continued to decline.

The largest increase in employment was again recorded in services (63,900 people, or 2.4%, in year-on-year terms), which was also the largest contributor to economic growth. The largest year-on-year increases in employment were recorded in market services, especially in real estate, renting and business activities. The high growth in employment in this branch, which accounted for more than 60% of the overall increase in services, indicated persisting high demand for these services at a time of still buoyant economic growth.[7] The renewed strong expansion of employment in financial intermediation also continued (up by 12,900 persons), while employment growth in other services – education, health and social care and veterinary activities – was relatively slower. Within industry, employment continued to increase in manufacturing (by 44,800 people, or 3.3%). This rise was linked

CHART II.23 LABOUR MARKET INDICATORS

**The continuing buoyant economic growth was accompanied by rising employment and fast growing wages**

(annual percentage changes; percentage points)

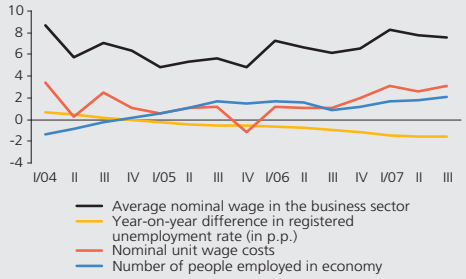



CHART II.24 EMPLOYMENT BREAKDOWN BY BRANCHES

**Employment kept rising in industry and services**

(contributions in percentage points; selected branches )

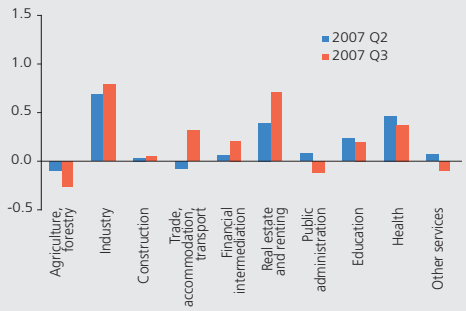
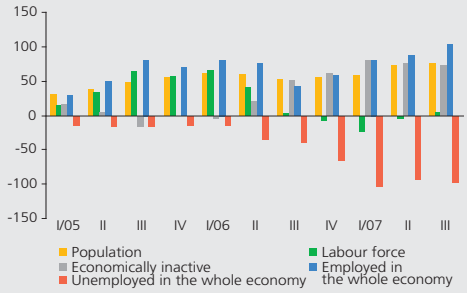



CHART II.25 LABOUR FORCE FLOWS

**The rising employment was accompanied by a rapid fall in the number of unemployed people**

(annual changes in thousands of persons)




7 Within the category of real estate, renting and business activities, employment increased primarily in legal and accounting activities, tax consultancy, including market research and public opinion polling, software consultancy and supply, and detective and protective services.

mainly with foreign direct investment, activities in related branches and the favourable demand situation.

The growing demand for labour continued to be met from external as well as domestic sources, as evidenced by significant (over 25%) annual growth in the number of foreign workers in 2007. Survey evidence suggested, however, that some branches were experiencing shortages of workers in the required occupations and with the right skills. This problem was particularly visible in industry and construction. Rising annual growth in the number of vacancies, which are a potential source of rising employment, also indicated growing labour demand in a situation where the economy is exceeding its potential output. The slope of the Beveridge curve meanwhile confirmed the cyclical nature of the growing labour demand in 2007.

**Chart II.26 The Beveridge curve**

**The rising creation of vacancies fostered a fall in unemployment**

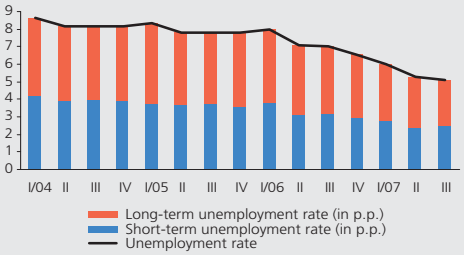
(seasonally adjusted numbers in thousands)


The rising employment in 2007 Q3 was accompanied by fast declining unemployment and a further decrease in the number of inactive persons,[8] who represent a potential labour force reserve (see Chart II.25). The general unemployment rate (according to the LFS) fell to a ten-year low (5.2%). The decline in unemployment was across the board in nature, as it was recorded in all regions of the country. Fast declining unemployment was confirmed by the MLSA data, according to which the registered unemployment rate declined by 1.6 percentage points year on year to 6.3% in Q3. In Q4, it reached 5.8%. This fall occurred amid a lower number of newly registered job applicants and a high number of excluded applicants.

**Chart II.27 The unemployment rate**

**The number of the long-term unemployed continued to fall, but the long-term unemployment rate remained high**

(percentages; percentage points; source: LFS)




The continuing cyclical decline in unemployment fostered a pronounced annual decline in the number of long-term unemployed people in 2007 Q3 (of 62,300 people according to LFS figures). However, this group still accounted for more than half of the unemployed, as shown in Chart II.27. A more fundamental solution to this problem continues to be hindered by the fact that most of the long-term unemployed have only basic education (70%), whereas the labour demand is focused mainly on secondary school graduates and university and vocational college graduates.

### II.4.2 Wages and productivity

Annual growth in the average nominal wage in the national economy remained relatively high in 2007 Q3, exceeding 7% (see Table II.3). Wages were affected mainly by the persisting buoyant economic growth accompanied by the fast declining unemployment. Compared to 2007 Q2, annual average nominal wage growth edged up to 7.6% in Q3. Average real wage growth was lower due to inflation, remaining flat at the Q2 level.

**Table II.3 Wages, productivity, unit labour costs**

**Fast growth in the average wage continued into 2007 Q3**

(annual percentage changes)

| | III/06 | IV/06 | I/07 | II/07 | III/07 |
|---|---|---|---|---|---|
| Average wage in monitored organisations | | | | | |
| nominal | 5.9 | 6.1 | 7.9 | 7.5 | 7.6 |
| real | 2.9 | 4.5 | 6.3 | 5.0 | 5.0 |
| Average wage in business sector | | | | | |
| nominal | 6.1 | 6.6 | 8.3 | 7.8 | 7.6 |
| real | 3.1 | 5.0 | 6.7 | 5.3 | 5.0 |
| Average wage in non-business sector | | | | | |
| nominal | 5.4 | 4.4 | 6.2 | 6.2 | 7.5 |
| real | 2.4 | 2.9 | 4.6 | 3.7 | 4.9 |
| Whole-economy labour productivity | 4.2 | 3.8 | 4.3 | 4.6 | 4.5 |
| Nominal unit wage costs | 1.1 | 2.0 | 3.1 | 2.6 | 3.1 |

As in the previous two quarters, the fast growth in the average wage in Q3 was driven primarily by wages in the business sector, which rose by 7.6% year on year. The persisting high wage growth in this sector, which is influenced mainly by profits and competition, chiefly reflected continuing increases in output, productivity and profit. It was also affected by the labour market, where, with unemployment falling rapidly, shortages of qualified workers were observed in some occupations. However, the wage growth in the business sector stopped accelerating in Q2 and Q3; on the contrary, a gradual decline in the growth rate was visible. The moderate upswing in the overall rate of growth of average wages in 2007 Q3 was thus due

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

to wage developments in the non-business sector, where average wage growth picked up noticeably from 6.2% in Q2 to 7.5% in Q3, mainly due to above-average wage increases in central government authorities. By contrast, average wage growth in health and social care was below average.

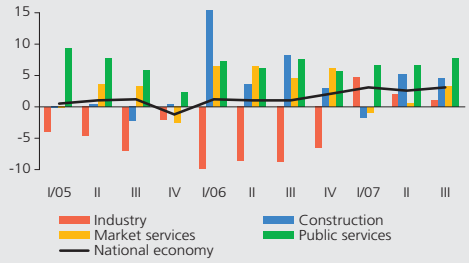
As regards inflation, further analysis is needed of whether the continued buoyant growth in the average wage was accompanied by corresponding growth in productivity. As Chart II.28 shows, nominal unit wage costs, which indicate potential inflation pressures in the wage area, continued rising in 2007 Q3. Their annual growth rose compared to Q2, reaching 3.1%, on a combination of a moderate pick-up in growth in wages and salaries and slowing real GDP growth. As in previous quarters, nominal unit wage costs rose fastest in public services, where average wage growth increased noticeably but the scope for productivity gains is limited. Growth in nominal unit wage costs in market services also increased, amid stronger growth in the average wage which was not matched by corresponding productivity growth. In industry, however, wage growth gradually weakened and, amid rising productivity, growth in the wage cost-output ratio eased.[9] Nominal unit wage costs in manufacturing continued to decline year on year (by 1.1%). However, this decline moderated significantly compared to 2006.

The evolution of nominal unit wage costs in 2007 Q3 confirmed an upward tendency in their year-on-year growth. For the second consecutive quarter, all the sectors under review contributed to the growth, although only non-market services are recording a long-term growth tendency. In the other monitored sectors, nominal unit wage costs remained highly volatile and were affected chiefly by demand fluctuations and sometimes other factors[10]. Although nominal unit wage costs in manufacturing continued to record a year-on-year decline, its significant moderation compared to the previous year can still be regarded as a consequence of the changing situation on the labour market at a time of strong economic growth.

**Chart II.28 Unit wage costs**

**All the monitored branches contributed to the rise in nominal unit wage costs in 2007 Q3**

(annual percentage changes)




## II.5 THE BALANCE OF PAYMENTS

*The balance of payments continued to record a gradual improvement in the output balance and a persisting high direct investment surplus, connected chiefly with the activities of foreign investors in the Czech Republic. However, this was accompanied by strong growth in the earnings of non-residents in the Czech Republic, reflected in a gradual deterioration of the income deficit. This deficit has also been widened over the last two years by the hiring of foreign workers to overcome the shortage of domestic workers. There was an outflow of portfolio investment, partly due to limited opportunities on the domestic stock market and to a negative interest rate differential.*

### II.5.1 The current account

In 2007 Q1–Q3, the current account ended in a deficit of CZK 73.9 billion (see Table II.4), or -2.8% of GDP (of which the estimated balance of reinvested earnings

**Table II.4 The balance of payments**

**The current account deficit increased in 2007 Q1–Q3 mainly as result of a deterioration of the income balance**

(CZK billions)

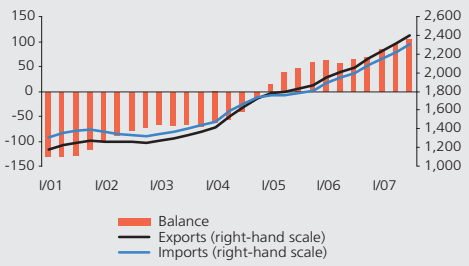
| | I-III/04 | I-III/05 | I-III/06 | I-III/07 |
|---|---|---|---|---|
| A. CURRENT ACCOUNT | -113.0 | -30.6 | -54.5 | -73.9 |
| Trade balance | -7.6 | 52.2 | 55.3 | 90.7 |
| Balance of services | 15.1 | 31.4 | 29.4 | 37.7 |
| Income balance | -124.6 | -123.2 | -128.0 | -186.5 |
| Current transfers | 4.1 | 9.0 | -11.2 | -15.8 |
| B. CAPITAL ACCOUNT | 3.9 | 2.5 | 3.0 | 6.4 |
| C. FINANCIAL ACCOUNT | 98.1 | 130.5 | 67.0 | 58.9 |
| Direct investment | 84.4 | 225.6 | 74.8 | 102.0 |
| Portfolio investment | 56.4 | -60.9 | -56.6 | -65.9 |
| Financial derivatives | 2.8 | -2.1 | -1.3 | 3.3 |
| Other investment | -45.5 | -32.0 | 50.2 | 19.5 |
| D. ERRORS AND OMISSIONS | 17.3 | -13.4 | -13.4 | 6.2 |
| E. CHANGE IN RESERVES (- = increase) | -6.3 | -89.6 | -2.1 | 2.5 |

9 Nominal unit wage cost growth was affected significantly in the first three quarters of 2007 by extraordinary output and productivity developments in the electricity, gas and water supply sector.

10 For example, there were specific adverse factors in construction which resulted in a decrease in output and only a modest annual increase in value added in 2007 Q3 (labour shortages in some occupations, abating shortages of some construction materials, delays in the preparation and financing of new civil engineering projects). In market services, the increase in nominal unit wage costs was probably due mainly to the marked rise in employment, which was not accompanied by a corresponding rise in output.

from direct investment was CZK -95.2 billion). In year-on-year terms, the deficit rose by CZK 19.6 billion (or 35%). The current account deficit widened despite an increase in the output surplus[11] of more than one-half. This was due chiefly to a sharp widening of the income deficit, associated mainly with a rapid increase in non-residents' FDI earnings (reinvested earnings and dividends). To a lesser extent, the rise in the current account deficit was linked with rising compensation of foreign employees.

**Chart II.29 The balance of trade**
**The annual moving total of the trade surplus increased further in 2007 Q3**
(CZK billions)

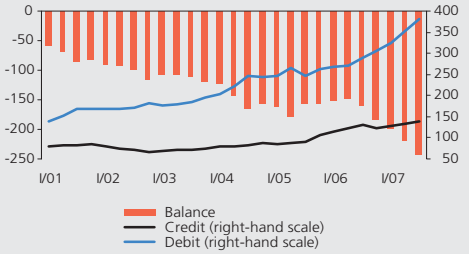



In 2007 Q1–Q3, the trade balance recorded a surplus of CZK 90.7 billion, up by CZK 35.4 billion on a year earlier (see Chart II.29). The year-on-year increase in the trade surplus was due to favourable price developments. The terms of trade recorded a positive year-on-year change of 3.1% in the first three quarters of 2007. More than one-third of the positive price effects were offset by unfavourable developments in real terms. The buoyant external demand and changes on the supply side of the economy due to FDI inflows and the relocation of production to the Czech Republic were counteracted by strong aggregate domestic demand growth and appreciation of the koruna against the euro. The year-on-year improvement in the trade balance continued into Q4, with the surplus increasing by CZK 10.8 billion in October and November according to preliminary data.

As regards the commodity structure, the trade balance showed very mixed trends in the first three quarters of 2007. The increase in the overall surplus continued to be aided chiefly by a rising surplus on machinery and transport equipment. The deficit on mineral fuels declined significantly, owing to an annual decrease in imports of oil and natural gas in terms of both physical volume and value (due to the appreciation of the koruna). By contrast, the surplus on manufactured goods classified by material and the deficit on chemicals recorded considerable deteriorations. From the geographical perspective, the year-on-year trade balance improvement was due primarily to an increase in the trade surplus with EU countries. Improvements were recorded particularly for trade with Slovakia and also with Germany. The total trade deficit with non-EU countries widened, chiefly because of a further increase in the trade deficit with China. By contrast, the high trade deficit with Russia decreased appreciably.

The balance of services ended 2007 Q1–Q3 in a surplus of CZK 37.7 billion (an annual increase of CZK 8.3 billion). The increase in the total surplus was a result of improved balances on transport (owing to faster growth in credits than debits) and other services (mainly because of reduced expenditure on financial services). The travel surplus fell slightly owing to faster growth in debits than credits.

**Chart II.30 The income balance**
**The annual moving total of the income deficit increased further in 2007 Q3**
(CZK billions)




The income deficit reached CZK 186.5 billion, representing a year-on-year deterioration of CZK 58.6 billion (see Chart II.30). The deficit still broadly corresponds to non-residents' FDI earnings (CZK 187.5 billion), more than half of which, however, are reinvested in the Czech Republic. The annual widening of the deficit reflected an increase in non-residents' estimated reinvested FDI earnings (of almost CZK 40 billion), a rise in non-residents' FDI dividends (of more than CZK 20 billion) and growth in expenditure on foreigners working in the Czech Republic (of roughly CZK 10 billion). By contrast, the main deficit-narrowing factors included increases in portfolio investment income, income on the CNB's international reserves, and commercial banks' interest income on deposits abroad.

Current transfers recorded a deficit of CZK 15.9 billion, deteriorating by CZK 4.7 billion year on year amid a sharp increase in both credits and debits. The primary factor underlying this deterioration in 2007 was an absence of direct compensation from the EU budget, which amounted to around CZK 6 billion in 2006.

11 The output balance is the sum of the trade balance and the balance of services.

### II.5.2 The capital account

The capital account recorded a surplus of CZK 6.4 billion in 2007 Q1–Q3, increasing by CZK 3.3 billion year on year. Its largest component was government revenues from EU funds, which, however, decreased very slightly in year-on-year terms. The capital account improvement was due exclusively to a write-off of government receivables of around CZK 4 billion, a formal factor that had increased debits in 2006.

### II.5.3 The financial account

In 2007 Q1–Q3, the financial account showed a surplus of CZK 58.9 billion, or 2.2% of GDP, representing a slight year-on-year decrease. The narrowing of the surplus was due to a higher annual outflow of portfolio investment, linked with demand among residents mainly for foreign shares and lower net borrowing by the government and the business sector in year-on-year terms. By contrast, an increase in the total surplus was fostered in particular by growth in the net inflow of direct investment.

Direct investment recorded a surplus of CZK 102.0 billion, representing a year-on-year increase of CZK 27.2 billion. The key to the improvement lies on the inflow side, as reinvested earnings growth was the most important factor. The inflow of investment in equity capital was also slightly higher than in the same period a year earlier. By contrast, loans provided by domestic subsidiaries to foreign parent companies reduced the direct investment inflow. These operations were conducted mostly in CZK. More than one-third of the foreign capital inflow went into manufacturing (especially chemicals and cars). Other important recipient industries included real estate (roughly one-third), financial intermediation (15%) and trade (10%). By territory, the biggest investor countries were Luxembourg, Korea, Poland and Cyprus (see Chart II.31). The outflow of Czech direct investment abroad moderated to CZK 16.5 billion year on year, owing mainly to a decrease in acquisitions abroad. The outflow of capital was channelled mainly into electricity generation and transport. Geographically, it went mainly to Georgia (a major investment in the energy sector) and Slovakia.

The net outflow of portfolio investment in 2007 Q1–Q3 was CZK 65.9 billion. In the same period of 2006 it had been almost CZK 10 billion lower. The annual increase in the deficit was due to increased interest of residents in foreign shares and a decline in non-residents' interest in domestic shares. The net outflow of capital was reduced by increasing demand among non-residents for domestic bonds. Holdings of foreign shares by residents showed a record rise of more than CZK 50 billion.

Financial derivatives transactions recorded a net inflow of CZK 3.3 billion. During Q3, however, the inflow slowed significantly (by more than CZK 11 billion), probably due to a fall in carry trades involving the koruna.

Other investment recorded a net capital inflow of CZK 19.5 billion (compared to a net inflow roughly CZK 10 billion higher in the same period of 2006). The main reasons underlying the decrease in the net capital inflow were that the public sector's net borrowing from abroad came to a virtual halt (falling by CZK 10.3 billion to CZK 0.9 billion) and net borrowing by the business sector recorded a decline. By contrast, the banking sector contributed to the overall capital inflow for the first time in a long time.

The CNB's international reserves decreased by CZK 8.9 billion to CZK 631.1 billion in 2007 Q4. The fall was again due mostly to valuation changes. In dollar terms, the reserves rose by USD 2.0 billion to USD 34.9 billion in the same period (see Chart II.33).

**Chart II.31 Foreign direct investment**

**Firms registered in Luxembourg were the largest foreign investors in equity capital in the Czech Republic in 2007 Q1–Q3**

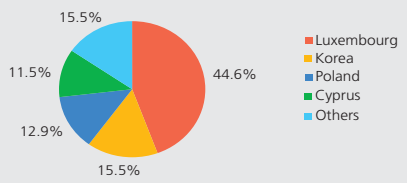



**Chart II.32 Portfolio investment**

**The net portfolio investment outflow increased sharply in 2007 Q3**

(CZK billions)

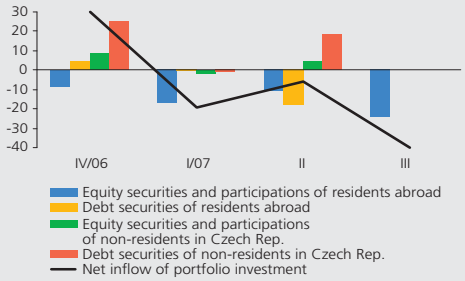



**Chart II.33 The CNB's international reserves**

**The CNB's international reserves increased in dollar terms in 2007 Q4**

(USD billions)

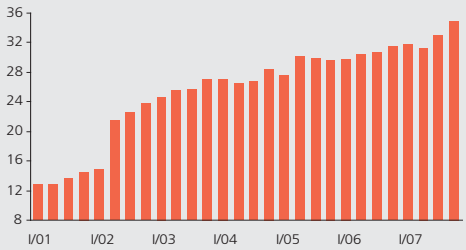


**Chart II.34 M1 and M2**

**M1 growth slowed**

(annual percentage changes)


**Table II.5 Monetary aggregate structure**

**Growth in short-term liquid deposits in quasi money increased owing to rising interest rates**

(quarterly averages and end-of-month stocks; annual percentage changes)

| | II/07 | III/07 | 10/07 | 11/07 | Share in M2, % 11/07 |
|---|---|---|---|---|---|
| M1 | 15.1 | 13.8 | 13.5 | 11.4 | 58.0 |
| Currency in circulation | 12.6 | 11.3 | 10.3 | 10.7 | 13.5 |
| Overnight deposits | 15.9 | 14.6 | 14.4 | 11.6 | 44.5 |
| M2-M1 (quasi money) | 7.2 | 7.9 | 6.7 | 11.1 | 42.0 |
| Deposits with agreed maturity | 4.7 | 5.3 | 2.1 | 8.2 | 29.1 |
| Deposits redeemable at notice | 18.4 | 16.2 | 18.4 | 19.0 | 12.4 |
| Repurchase agreements | -49.7 | -11.2 | 17.0 | 6.2 | 0.5 |
| M2 | 11.6 | 11.3 | 10.6 | 11.3 | 100.0 |

**Chart II.35 Interest rates on deposits**

**Interest rates on deposits with agreed maturity rose by more than interest rates on overnight deposits**

(new business; percentages)

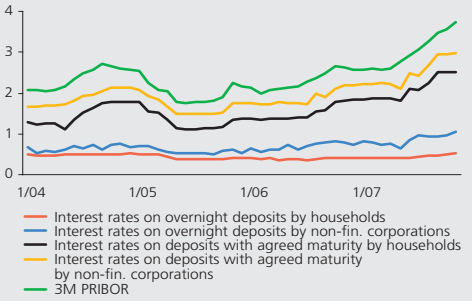



**Table II.6 Loan structure**

**Demand for loans was high**

(quarterly averages and end-of-month stocks; annual percentage changes)

| | II/07 | III/07 | 10/07 | 11/07 | Share in total loans, % 11/07 |
|---|---|---|---|---|---|
| Non-financial corporations | 19.0 | 20.4 | 20.3 | 16.8 | 46.9 |
| Loans up to 1 year | 11.0 | 17.7 | 19.6 | 22.7 | 18.8 |
| Loans over 1 year and up to 5 years | 20.9 | 17.8 | 15.8 | 3.6 | 10.2 |
| Loans over 5 years | 26.6 | 25.0 | 24.0 | 19.4 | 17.9 |
| Households | 31.4 | 31.8 | 32.4 | 33.1 | 43.8 |
| Consumer credit | 26.3 | 27.7 | 27.3 | 27.6 | 8.5 |
| Loans for house purchase | 33.6 | 34.0 | 34.1 | 34.9 | 30.8 |
| Other loans | 27.3 | 25.8 | 30.6 | 31.3 | 4.5 |
| Non-monetary financial institutions | -5.0 | 5.2 | 17.2 | 26.5 | 9.3 |
| Total loans | 21.3 | 23.5 | 24.9 | 24.3 | 100.0 |

## II.6 MONETARY DEVELOPMENTS

*Money supply growth slowed slightly in 2007 Q3. Rising interest rates were reflected in a downward trend in the highly liquid money making up M1. Demand for loans remained strong. However, the growth in interest rates gradually fed through to the individual loan types. Increasing household debt, accompanied by rising interest rates on new loans, resulted in a higher ratio of interest costs to gross disposable income. Indicators of the appropriateness of the money supply growth suggest potential medium-term inflationary risks.*

### II.6.1 Money

Annual M2 growth slowed in 2007 Q3 compared to the previous period. This trend continued into October, but the money supply growth then picked up to 11.3% in November (see Chart II.34). The lower money supply growth mainly reflected a decline in net credit to the government. This notwithstanding, the monetary expansion remained high, primarily due to growth in loans to corporations and households. The monetary overhang and the nominal money gap were more inflationary in Q3, while the real money gap was broadly neutral. The money supply continued to grow faster in Q3 than the estimated equilibrium demand for money, taking into account potential output and the inflation target.

Annual M1 growth also slowed in Q3, owing to the rising interest rates and the rising opportunity costs of holding overnight deposits (see Table II.5 and Chart II.35). Within M1, overnight deposits recorded less significant growth. The decline in the rate of growth of currency in circulation recorded in the second half of 2007 was associated with slightly weaker growth in household consumer demand and a decline in the consumer confidence indicator. Demand for short-term time deposits within quasi-money showed an increase. No increase in demand was recorded for the longer-term components of the money supply, i.e. deposits with an agreed maturity of over two years and deposits redeemable at notice of over three months, mainly due to lower growth in long-term interest rates compared to short-term interest rates. Such deposits display lower liquidity and relatively low yields. In terms of money-holding sectors, household deposits remained the main contributor to money supply growth. In Q3, their contribution decreased, as did that of deposits of non-financial corporations. By contrast, the contribution of deposits of non-monetary financial institutions increased. In November, however, the contribution of deposits of corporations increased again.

### II.6.2 Credit

Growth in MFI loans to corporations and households was strong in 2007. In November, however, it slowed to 24.3% (see Table II.6). The growth in interest rates is beginning to manifest itself in the individual types of loans.

The annual growth rate of loans to non-financial corporations increased in Q3. Subsequently, in October and November, the growth rate of loans to corporations declined to 16.8%. Medium-term and long-term loans recorded lower growth than previously, while growth in short-term loans increased. The sizeable decline in growth in medium-term loans and faster growth in short-term loans recorded in November were linked with a change in statistical reporting in one of the selected banks. Despite the said developments, the growth rate of loans with longer maturities is gradually slowing in the longer term. This is related to lower investment activity by corporations, whereas the continuing growth in short-term loans is probably associated with corporations' need to finance working capital. Turning to the sector structure, the higher growth in loans in Q3 was mainly due to

loans to manufacturing, trade, financial intermediaries and sectors active in the real estate business. Slower growth in loans was subsequently recorded in all these sectors, with only loans to financial intermediaries continuing to rise.

Annual growth in loans to households picked up pace in Q3 (see Chart II.36). This rise continued into October and November. As for the structure of loans for house purchase, building society loans recorded higher growth than in the same period a year earlier, while mortgage loans saw lower growth, possibly due to the gradual rise in interest rates. However, the share of mortgage loans in the growth in loans for house purchase remains almost three times higher than that of building society loans. The real estate market is sending out similar signals. According to real estate brokers and developers, a cooling of demand for some flats can be observed. However, demand for large luxury flats remains high and no decline is expected, despite the introduction of higher, 19% VAT on construction work as from 2008. The rate of growth of consumer credit was high, although it slowed in some months of the period under review along with a decline in the consumer confidence indicator and a slight downswing in household consumption growth. Households also borrowed 18.4% more from non-bank institutions in Q3 than in the same period a year earlier.

The ratio of total (bank and non-bank) household debt to gross disposable income increased in Q3 by 2 percentage points to 46% (as compared to 92% in the euro area), mainly due to bank debt. The growing debt and rising interest rate on loans resulted in a higher ratio of interest costs to gross disposable income. Interest costs rose at almost twice the rate as interest income, although interest income still exceeded interest costs. The difference between the two indicators gradually narrowed. Interest costs paid by households reached 2% of gross disposable income, while interest income recorded a figure of 2.7%. According to the household budget survey, the debt burden of households in terms of average payments of principal and interest per capita increased by a further 0.3 percentage point in Q3, to 4.9%.

The lending conditions tightened, owing to an increase in the average interest rate on new loans. The average interest rate on new loans reached 6.8% in November and has risen by 0.8 percentage points since the start of last year as a result of the increases in monetary policy interest rates. The spread between the average interest rate on new loans and the 1Y PRIBOR has remained flat in recent months, suggesting that the loan risk premium has yet to change significantly.

The average interest rate on new loans to households increased by 0.9 percentage point in 2007, to 11.7% (November 2007). The interest rate on new loans for house purchase increased slightly, by 0.6 percentage point to 5.2% (see Chart II.37). Interest rates on new loans for house purchase with a fixation of up to five years rose more strongly, while interest rates with longer fixations increased by less, in line with long-term financial market interest rates. Spreads between interest rates with longer (over one year) and shorter fixations (up to one year) reached negative figures. Interest rates with fixations of over five years recorded the largest increase in spreads. This notwithstanding, demand for loans with interest rate fixations of over one year and up to five years remained highest. The interest rate on new consumer credit was declining until April but has since risen to 13% (see Chart II.38). However, since the start of the previous year it has increased by just 0.1 percentage point, which suggests that it has not always been fully in line with financial market interest rates. The interest rate on new loans to non-financial corporations was up by 0.8 percentage point on the start of last year, at 5.2% (see Chart II.39). Since almost all loans to corporations have a floating rate or an initial rate fixation of up to one year, the impact of growth in money market interest rates on client interest rates is thus immediate in the case of loans to corporations.

**Chart II.36 Loans to households**

**Growth in total loans to households increased**

(annual percentage changes)

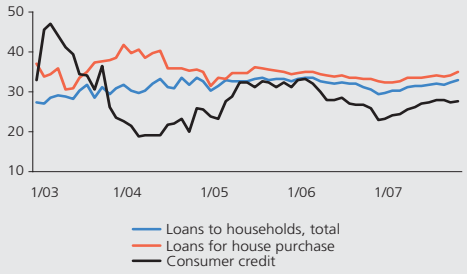



**Chart II.37 Interest rate on lending for house purchase**

**The interest rate on lending for house purchase increased**

(new business; percentages)

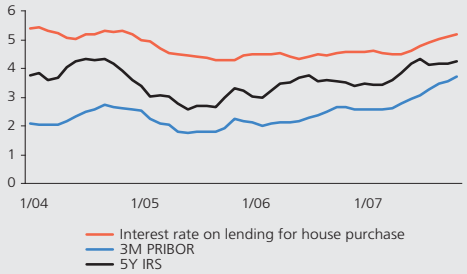



**Chart II.38 Interest rate on consumer credit**

**The interest rate on consumer credit was high**

(new business; percentages)

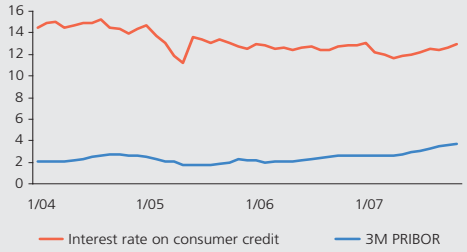
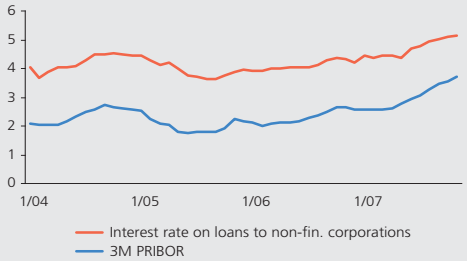



**Chart II.39 Interest rate on loans to non-financial corporations**

**The interest rate on loans to non-financial corporations showed similar growth to the 3M PRIBOR**

(new business; percentages)



**BOX 3**
**The quarterly financial accounts statistics – New statistics at the CNB**

In October 2007, the Czech National Bank launched regular publication of quarterly financial accounts statistics. This is a brand new area of statistics for the CNB, providing complete information about financial assets and obligations in individual economic sectors, the financial relations between them and the external relations of the economy as a whole. The financial accounts form an integral part of the national accounts and, in their aggregate form, record the opening and closing balances of financial assets and liabilities on an unconsolidated basis (financial balance sheets), as well as the individual factors that affect such balances, i.e. transactions (the financial account), price factors (the revaluation account) and other factors (the other changes account). A notable feature of the financial accounts statistics is that they link the outputs of other published statistics at the macroeconomic level, harmonising them and thus providing consistent information not only about individual economic sectors, but also about their interconnections broken down by financial instrument.

The financial accounts are an important source of information, with broad application both in monetary policy analyses of the monetary transmission mechanism and in financial stability analyses of the economy as a whole and its individual sectors. For this reason, the ECB also pays close attention to these statistics. It is developing quarterly financial accounts statistics as an integral part of the system of quarterly accounts for the euro area.

Responsibility for compiling the quarterly financial accounts in the Czech Republic rests with the Czech National Bank. Data are released 110 days after the end of the relevant quarter. Currently, only the balance sheets of financial assets and liabilities of individual economic sectors are published, broken down by economic instrument. The information includes previously unpublished quarterly data, such as the structure of financial instruments in the Czech economy (see Chart 1), the net financial positions of individual economic sectors (see Chart 2) and the structure of financial assets and liabilities in individual economic sectors. The statistics, together with detailed information relating to the quarterly financial accounts methodology and the publication schedule, are available in the *Statistics* section of the CNB website.

CHART 1 (BOX) STRUCTURE OF FINANCIAL INSTRUMENTS
**Currency and deposits along with shares account for almost 50% of total financial assets**
(percentage shares; 2007 Q3)

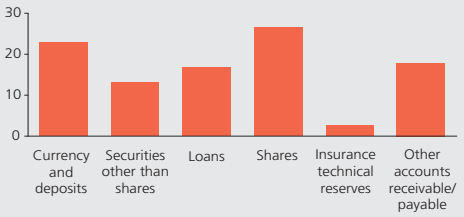
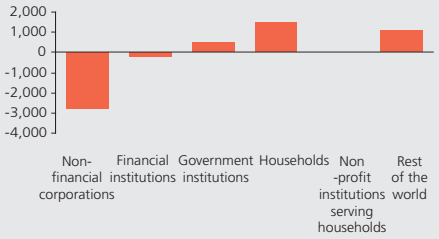


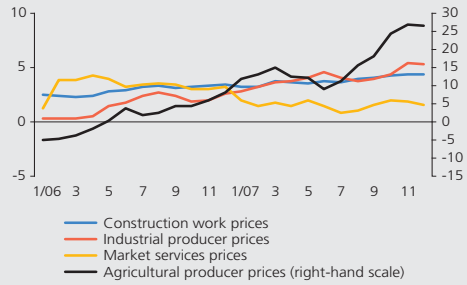

CHART 2 (BOX) NET FINANCIAL ASSETS
**Non-financial corporations are the largest net institutional debtor**
(CZK billions; 2007 Q3)




## II.7 IMPORT PRICES AND PRODUCER PRICES

*Import prices had mixed effects on the individual price categories in 2007 Q4. Renewed annual growth in import prices of mineral fuels, caused by a sharp rise in prices of energy-producing materials on world markets, increased producers' input costs. Fast growing global prices of food and agricultural commodities and energy prices also had an inflationary effect. On the other hand, slowing growth in import prices of non-energy-producing materials (particularly metals), and declining import prices of manufactured goods due to appreciation of the koruna's exchange rate, fostered a decline in the external cost pressures on domestic prices. These contrary trends in input prices fed through to producer prices. Overall, industrial producer price inflation rose, mainly due to the high prices of energy and food. However, faster growth in prices was recorded in only a few branches. By contrast, producer prices showed slower or flat growth in numerous branches of manufacturing. Inflation also rose in other categories of the production sector, but annual market services price inflation remained below the 2006 level.*

CHART II.40 PRODUCER PRICES
**Inflation rose in most branches of the production sector in 2007 Q4**
(annual percentage changes)



### II.7.1 Import prices

Given the high openness of the Czech economy, import prices are an important domestic inflation factor. Their annual decline has gradually been deepening since September 2007, and reached 1.6% according to the latest figures for November. Chart II.41 shows that this was due to prices of other imports[12] and of non-energy-producing materials and semi-finished products.

The deepening decline in prices of other imports, observed since September, was mainly due to the continuing annual appreciation of the koruna-euro and koruna-dollar exchange rates,[13] which fostered noticeably faster price declines in all major other import categories. The largest decline was recorded for import prices of miscellaneous manufactured articles (5%), but the fall in prices of imported machinery and equipment was also large (see Table II.7). Import prices of non-energy-producing materials and semi-finished products, which usually exhibit greater volatility than prices of commodities with a higher degree of processing, showed annual growth until August. However, their annual growth recorded a sizeable decline in September, due to considerably weaker growth in prices of metals on world markets and to the appreciation of the koruna, and in the following two months import prices fell in this category. This decline was reflected in the manufactured goods category; import prices of non-energy-producing materials continued to rise (by 6.2% in November), despite considerably slower annual growth in world prices of metals, accompanied by an appreciating koruna.

Prices of mineral fuels showed the opposite trend to prices of imported non-energy-producing materials. As a result of the renewed buoyant growth in world prices of energy-producing materials, the previous decline in import prices of mineral fuels – despite rapid appreciation of the koruna-dollar exchange rate – was replaced by modest annual growth in September (see Chart II.42). This reversal was in line with the movements in world prices of oil and natural gas. The sharp growth in world prices of Brent crude oil, which started in September, culminated in November in an annual increase of 53.7%. World prices of natural gas, which are affected by oil prices with a lag, rose by a mere 5.3% in November. Despite the continuing appreciation of the koruna, import prices of food also recorded faster annual growth, reaching 6% in November.

In Q3 and the first two months of 2007 Q4, import prices confirmed continuing contrary price trends in the structure of imports. Starting in September, imports were affected by a change in the trend in the two key categories of imported commodities – energy-producing materials and other materials. By contrast with the previous period, import prices of non-energy-producing materials and semi-finished products fostered a reduction in domestic producers' costs. On the other hand, the renewed annual growth in import prices of energy-producing materials signalled a build-up of inflationary pressures among producers, especially those at the beginning of the production chain (primary oil-product processing). The rapid growth in world prices of food, which affected domestic producers' selling prices, and strengthening growth in import prices of food were also a source of inflationary pressures among producers. Overall, import prices suggested mixed impacts on prices of individual producers.

**Chart II.41 Import prices**

**The annual decline in import prices has been deepening since September**

(annual percentage changes; contributions in percentage points)

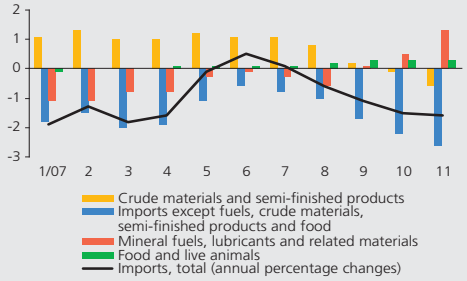



**Table II.7 Structure of the import price index**

**The decline in import prices was particularly acute for products with a higher degree of processing**

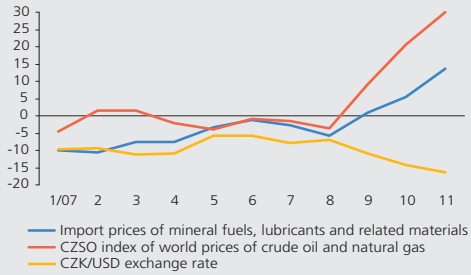
(annual percentage changes)

| | 8/07 | 9/07 | 10/07 | 11/07 |
|---|---|---|---|---|
| IMPORTS, TOTAL | -0.6 | -1.1 | -1.5 | -1.6 |
| of which: | | | | |
| food and live animals | 4.4 | 5.6 | 6.0 | 6.0 |
| beverages and tobacco | 2.6 | 0.3 | -0.3 | 1.1 |
| crude materials inedible except fuels | 12.8 | 10.2 | 7.7 | 6.2 |
| mineral fuels and related products | -5.8 | 0.9 | 5.5 | 13.6 |
| animal and vegetable oils | 14.6 | 16.9 | 20.0 | 18.9 |
| chemicals and related products | 0.7 | -0.6 | -1.5 | -1.9 |
| manufactured goods classified by material | 2.4 | -0.2 | -1.5 | -3.8 |
| machinery and transport equipment | -2.6 | -3.5 | -4.2 | -4.8 |
| miscellaneous manufactured articles | -1.6 | -2.6 | -3.6 | -5.0 |

**Chart II.42 Mineral fuel prices**

**The impact of the sharp growth in world prices of energy-producing materials on import prices was partially dampened by appreciation of the koruna-dollar exchange rate**

(annual percentage changes)




12 This category mainly contains products with a higher degree of processing: machinery and transport equipment, miscellaneous manufactured articles, and chemicals and related products.

13 The koruna-euro exchange rate appreciated by 2.8% and 5.8% year on year in September and December respectively. The koruna-dollar exchange rate appreciated by 10.9% and 15.1% year on year in the same months.

### II.7.2 Producer prices

#### *Industrial producer prices*

In 2007 Q4, industrial producer prices recorded a continued pick-up in growth, as observed since September. The annual growth, exceeding 5% since November,[14] was the highest in three years. The further strengthening of inflation in industry in Q4 was mainly due to the renewed annual growth in import prices of oil and the rapid rise in prices of agricultural and food commodities on world markets, which passed through to producer prices in the food industry.

Industrial producer price inflation was most affected in 2007 Q4 by producer prices in the food industry, for the reasons described in detail in the section *Agricultural producer prices*. The gradual pick-up in their annual growth observed since the start of 2007, accelerated sharply to above 10% in Q4 (11.8% in December). Producer prices in the food industry thus accounted for more than one-third of the annual industrial producer price inflation in December. The impact of the renewed growth in world prices of oil was clearly seen in primary oil-product processing – manufacture of coke and refined petroleum products. Prices in this sector rose by 6.8% in September, but their annual growth in December was roughly three times higher. Prices also continued to rise apace in the electricity, gas and water supply industry (7.6%) and in mining and quarrying, where prices recorded a sizeable increase in growth (to 9.2%).

By contrast, a pronounced slowdown in growth in import prices of metals was reflected in slower growth in producer prices in the manufacture of basic metals and fabricated metal products (to 2.3% in December). Inflation in a number of other branches of manufacturing also slowed, as shown in Chart II.44. In December, however, the only annual declines in producer prices were recorded in manufacture of transport equipment and manufacture of rubber and plastic products.

The sizeable upswing in industrial producer price inflation in 2007 Q4 was thus due to price developments in just a few sectors. The fast growing world prices of food and energy-producing materials, partly dampened by the annual appreciation of the koruna, passed through significantly to producer prices in only two sectors – primary oil-product processing and the food industry. Prices of energy producers also rose. The price growth in most other sectors either slowed or remained flat at the end-Q3 level. However, continued fast growth in prices of energy-producing materials of foreign and domestic origin could lead to a gradual build-up of cost pressures in some sectors, unless it is offset by increasing productivity or in other ways.

#### *Agricultural producer prices*

Agricultural producer prices continued to record sharp annual growth in 2007 Q4, culminating in a record high in November (26.9%). The growth slackened only very slightly in December, to 26.6%. Since Q3, this extraordinary rise has been due not only to crop prices, but also to livestock product prices (see Chart II.45).

Underlying this sizeable annual rise in agricultural producer prices in the Czech Republic was growth in prices of agricultural and food commodities abroad, due, in turn, to two main factors. On the one hand, the long-running world price growth is due to demand for food of animal and vegetable origin, mainly reflecting the fast

CHART II.43 INDUSTRIAL PRODUCER PRICES
**Industrial producer price inflation rose again in 2007 Q4**
(annual percentage changes; contributions in percentage points)

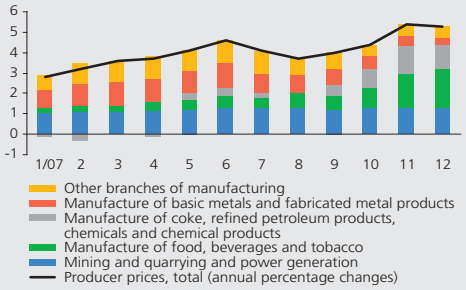



CHART II.44 PRICES IN SELECTED BRANCHES
**Inflation slowed in a number of branches of manufacturing**
(annual percentage changes; selected branches)

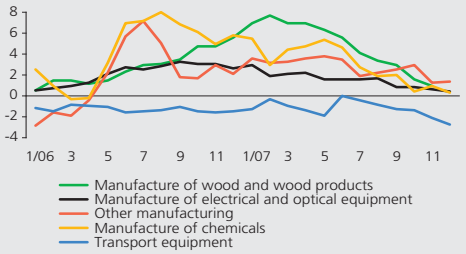
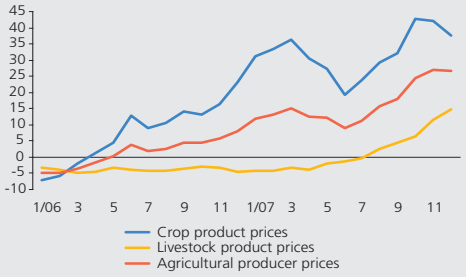



CHART II.45 AGRICULTURAL PRODUCER PRICES
**The upswing in agricultural producer price inflation was due to prices of both crop products and livestock products**
(annual percentage changes)




14 Annual increases of 5.4% and 5.3% were recorded in November and December respectively.

economic growth in a number of developing economies, particularly in Asia. On the other hand, prices have been affected by one-off falls in crop production (mainly cereals) caused by bad crops not only in most EU countries, but also in the USA, Australia and Ukraine, which are major world exporters. These factors have resulted in a sharp increase in crop prices in the Czech Republic, despite a slightly above average domestic harvest in 2007.

The effect of prices abroad, especially for cereals and oil crops, fostered a further marked annual pick-up in crop price inflation (to 37.6% in December). Livestock product prices, which account for around two-thirds of the overall agricultural producer price index, saw a pronounced pick-up in annual growth in Q4 (to 14.9% in December). Their buoyant annual growth was due to a combination of sharply rising external demand and declining domestic production. The rapid appreciation of the koruna-euro exchange rate in Q4 dampened the impact of external price effects on domestic prices to only a limited extent.

### *Other producer prices*

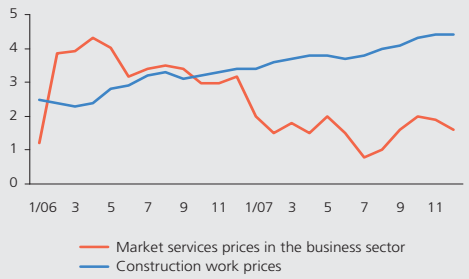
Annual construction work price inflation edged up in 2007 Q4, reaching 4.4% according to the latest figures for December. This confirmed a continuing long-term growth tendency caused mainly by high domestic demand. However, growth in prices of materials and products consumed in the construction industry slowed from its previous high levels for the second consecutive quarter. According to the November and December data, this growth was lower than that recorded for construction work for the first time in a long time (by 3.5% in December).

Unlike construction work prices, market services prices in the business sector rose more slowly in 2007 Q4 than in 2006, although their annual growth increased noticeably in autumn 2007 (see Chart II.46). This was due to prices of business services and real estate and rental services (2.6% year on year in December). In the other service categories included in the market services index, price growth slowed or remained flat at the September level. Sewerage collection charges and freight transport and storage again showed the fastest growth (of 5.6% and 3.2% year on year respectively in December), while insurance and communications continued to record a price decline.

CHART II.46 OTHER PRODUCER PRICES

**Construction work price inflation continued to edge up**

(annual percentage changes)




## II.8 INFLATION

*Annual inflation increased significantly above 5% in 2007 Q4, well above the upper boundary of the inflation-target tolerance band. This extraordinary price movement was due mainly to external factors. In particular, it reflected high growth in world prices of energy-producing materials and food. In 2007 Q4, monetary-policy relevant inflation crossed over from below the inflation target into the upper half of the tolerance band. With the benefit of hindsight, one can assess the past monetary policy settings as having been broadly appropriate.*

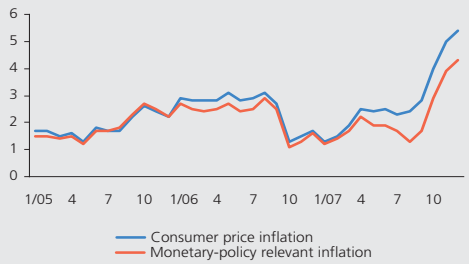
### II.8.1 Current inflation

The rise in inflation[15] observed since August continued into 2007 Q4 (see Chart II.47). The growth picked up pace significantly from October onwards,

CHART II.47 INFLATION

**Annual inflation increased sharply in 2007 Q4**

(annual percentage changes)




15 Measured by annual growth in consumer prices.

**CHART II.48 INFLATION COMPONENTS**

**Food prices, fuel prices and regulated prices recorded the most growth**

(annual percentage changes; excluding tax changes)

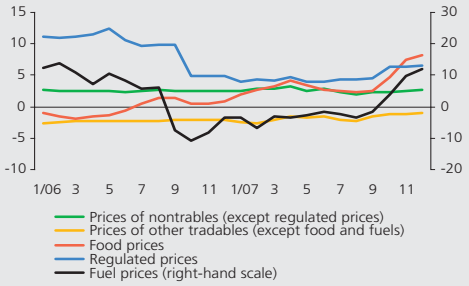



**CHART II.49 STRUCTURE OF INFLATION**

**Food prices and regulated prices accounted for almost 60% of the annual inflation in December**

(annual percentage changes; contributions in percentage points)

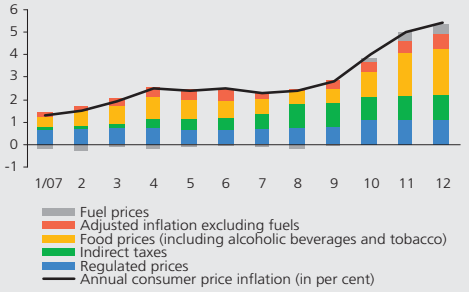
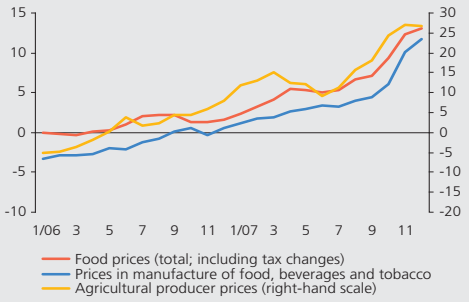



**CHART II.50 FOOD PRICES**

**Food prices rose very rapidly during 2007 Q4**

(annual percentage changes; including changes to indirect taxes)




reaching an extraordinary 5.4% in December. Inflation was 2.6 percentage points higher than in September, whereas in the previous quarter it had recorded an annual increase of just 0.3 percentage point. This significant rise was due to a combination of several factors, mostly of external origin, which passed through to prices of most major components of consumer price inflation. Food prices were the biggest contributors to the pick-up in headline inflation, but the contributions of fuels and regulated prices were also significant. Adjusted inflation excluding fuels also rose noticeably in Q4.

Annual monetary-policy relevant inflation, which is the main inflation indicator for the CNB's monetary policy decision-making, was lower than annual headline inflation throughout 2007 Q4. However, its annual increase at the end of 2007 was as pronounced as that of headline inflation, as the first-round effects of changes to indirect taxes on inflation remained almost unchanged compared to September.

The marked rise in consumer prices was due mainly to external cost factors – high growth in world prices of energy and food, whose impact on domestic producer and consumer prices was only partly offset by the annual appreciation of the koruna exchange rate. The impact of domestic inflationary factors on prices (in particular, stronger growth in nominal unit wage costs and continuing fast growth in consumer demand) was less significant. The long-running decline in import prices of products with a higher degree of processing, particularly industrial consumer products intended for the retail market, had the opposite effect.

Consumer prices were most affected in 2007 Q4 by food prices (see Chart II.50). This was due mainly to high growth in world prices of food and agricultural commodities,[16] which subsequently passed through to import prices of food. At the same time, agricultural producers' selling prices increased owing to increased external demand for domestic food production. This situation then facilitated a rise in production prices in the food industry. The annual appreciation of the koruna exchange rate only partly offset the impact of world prices of food on domestic prices, so food prices rose very quickly during Q4. The annual growth in food prices also seems to have been significantly affected by the partial "advance" pass-through of the increase in the VAT rate into prices of some food as early as Q4.[17] The explanation can be seen in business policies of retailers, led by efforts to distribute the VAT rate increase over a longer period or to partially apply it at a time of increased demand for food and growth in food prices due to cost pressures. Food prices thus increased by 13% year on year in December 2007. Adjusted for the first-round effects of the changes to indirect taxes,[18] they increased by 8.2% year on year, up by a sizeable 5.7 percentage points compared to September.

Fuel prices also recorded significantly faster growth, rising by 12% year on year in December after recording a decline of 1.8% in September. This rise was closely linked with the renewed high growth in oil prices on world markets and a related increase in mineral fuel import prices, which rose by 13.6% year on year according to the latest data for November. It was also partly due to base effects. As with food prices, the impact of world prices of oil on domestic prices was only partly offset by the annual appreciation of the koruna-dollar exchange rate.

16 For details see section II.7 *Import prices and producer prices* in this Inflation Report and Box 3 *The causes of the sharp growth in world prices of cereals* in the October 2007 Inflation Report.

17 An increase in VAT from 5% to 9% effective from 1 January 2008.

18 These effects stem from increases in excise duties on tobacco products effective since 1 April 2006 and 1 March 2007, which fed through to inflation in the course of 2007.

The higher inflation in 2007 Q4 was also fostered by regulated prices, which rose by 6.5% year on year in December. This increase was due to a change in prices of natural gas for households in response to the rising prices of natural gas on world markets. In September these prices had recorded an annual decline (of 6.5%), but in October they showed annual growth of 3.6%.

Adjusted inflation except fuels, which did not exceed 1% year on year in the first three quarters of 2007, also recorded an annual increase in Q4 (to 1.2% in December). This was due mainly to faster annual growth in prices of nontradable commodities (to 2.6% in December). They were most affected by higher prices in the hotels and restaurants category, which reflected the high growth in food prices. At the same time, the annual decline in prices of other tradable commodities, which are greatly affected by prices of consumer products abroad and by the koruna's exchange rate, slowed to -1% in December. Prices in the clothing and footwear category, which had long been declining moderately year on year, showed a very slight upturn in 2007 H2, owing to the exchange rate depreciation in H1 and strong domestic consumer demand.

In the consumer basket, the inflationary factors of both external and domestic origin – especially prices of energy-producing commodities and food – were clearly felt in terms of rising consumer prices of food, housing, transport, and hotel and restaurant services. The fast growing prices of energy-producing commodities and food also affected inflation in other European countries. The year-on-year increase in the HICP in the EU countries was considerably lower than that in the Czech Republic over the same period (see Chart II.52).

### II.8.2 Fulfilment of the inflation target

Headline inflation was above the tolerance band of the CNB's inflation target in 2007 Q4 (see Chart II.53). 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 Q4 is roughly from April 2006 to December 2006. For the sake of clarity, the analysis of the accuracy of the forecasts is limited here to a comparison of the forecast drawn up in July 2006, with inflation in 2007 Q4.

The July 2006 forecast had predicted a slight decline in headline inflation in the rest of 2006. In 2007, inflation was expected to rise to the upper boundary of the tolerance band of the inflation target (see Chart II.53). Rising regulated prices of energy and the impact of higher indirect taxes on cigarettes were expected to have a fundamental effect on inflation. Pressures from the real economy were expected to build up gradually over the forecast horizon owing to moderately easy real monetary conditions, particularly in the exchange rate component. This was also reflected in a projected rise in adjusted inflation excluding fuels.

Headline inflation was below the forecast in reality, but in 2007 Q4 rose sharply above the July 2006 forecast. The deviation recorded in 2007 Q4 primarily reflected higher food prices. However, regulated prices and fuel prices also increased unexpectedly quickly and the contribution of changes to indirect taxes was higher, too. Adjusted inflation excluding fuels was the only component of inflation to rise more slowly than predicted in the forecast (see Table II.8).

**Chart II.51 Consumer basket prices**

**In the consumer basket, prices of food, housing and transport were most affected by external factors**

(December 2007; contributions in percentage points)

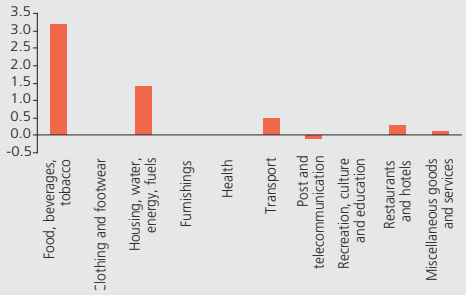



**Chart II.52 The HICP in the Czech Republic and the EU**

**Inflation in the Czech Republic rose more sharply than inflation in the EU countries in 2007 Q4**

(annual percentage changes)

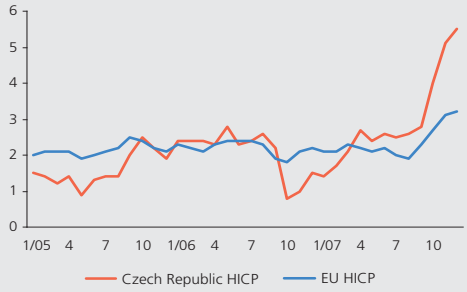



**Chart II.53 Forecast versus actual inflation**

**Actual inflation in 2007 Q4 rose above the July 2006 forecast**

(annual percentage changes)

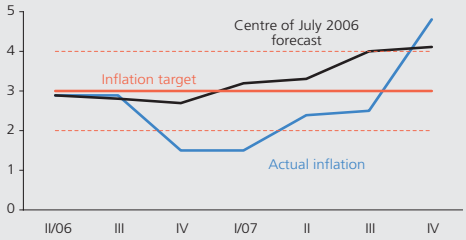



**Table II.8 Fulfilment of the inflation forecast**

**Adjusted inflation excluding fuels and food prices deviated most from the forecast**

(annual percentage changes; contributions in percentage points)

| | July 2006 forecast | 2007 Q4 outturn | Contribution to total difference[a)] |
|---|---|---|---|
| CONSUMER PRICES | 4.1 | 4.8 | 0.7 |
| Breakdown into contributions: | | | |
| regulated prices | 4.3 | 6.4 | 0.4 |
| first-round impacts of changes to indirect taxes | 0.9 | 1.1 | 0.2 |
| food prices [b)] | 2.2 | 6.8 | 1.0 |
| fuel prices [b)] | 1.2 | 8.5 | 0.2 |
| adjusted inflation excl. fuels [b)] | 3.1 | 1.0 | -1.1 |

a) owing to rounding, the sum of the contributions need not be equal to the total difference; the contributions are influenced by changes in weights in the consumer basket as from January 2007

b) excluding the first-round impacts of changes to indirect taxes

**Table II.9 Fulfilment of the external assumptions**

**The effect of the external environment on the domestic economy was rather inflationary compared to the July 2006 forecast**

(annual percentage changes unless otherwise indicated)

| | | III/06 | IV/06 | I/07 | II/07 | III/07 | IV/07 |
|---|---|---|---|---|---|---|---|
| GDP in euro area a),b),c) | p | 1.8 | 2.0 | 1.4 | 1.5 | 1.5 | 1.6 |
| | o | 2.7 | 3.5 | 3.2 | 2.6 | 2.6 | - |
| CPI in euro area b),c) | p | 1.7 | 1.6 | 2.6 | 2.1 | 1.9 | 2.0 |
| | o | 1.7 | 1.5 | 1.8 | 1.8 | 1.9 | - |
| 1Y EURIBOR | p | 3.4 | 3.5 | 3.5 | 3.6 | 3.7 | 3.7 |
| (percentages) | o | 3.6 | 3.9 | 4.1 | 4.4 | 4.6 | 4.7 |
| USD/EUR exchange rate | p | 1.28 | 1.29 | 1.29 | 1.30 | 1.30 | 1.30 |
| (levels) | o | 1.27 | 1.29 | 1.31 | 1.35 | 1.37 | 1.45 |
| Brent crude oil price | p | 70.1 | 72.0 | 72.8 | 72.9 | 72.6 | 72.1 |
| (USD/barrel) | o | 70.2 | 59.6 | 58.1 | 68.7 | 74.9 | 88.8 |

p - prediction, o - outturn
a) at constant prices
b) seasonally adjusted
c) effective indicator

The overall effect of the external environment on domestic inflation in the period under review was inflationary compared to the July forecast assumptions. The impact of higher external demand, interest rates and oil prices was only partly offset by a weaker dollar-euro exchange rate (see Table II.9).

According to the current view, the monetary policy settings in the key period were broadly in line with the assumptions of the July forecast. Nominal interest rates were slightly lower in the key period compared to the July forecast. The effect of real interest rates was also slightly easier. The koruna exchange rate was slightly stronger in the key period than predicted in the July 2006 forecast, and its effect was tight.

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 July 2006 and the present include an extension of the core prediction model to include the effect of real wages on inflation and a change in the distribution of the real equilibrium appreciation across the individual inflation components. Other things being equal, these changes would together have led to a lower inflation forecast and to lower forecast-consistent interest rates. The most recent changes to the forecasting system consist in limited pass-through of inflation expectations across individual price categories and increased forward-lookingness of inflation expectations and monetary policy aggression (for details see Box 4 *Changes to the CNB's core prediction model*).

Any revisions made to economic indicators since the forecast was drawn up also have an effect on the fulfilment of the forecast. A new consumer basket acted towards lower inflation. A large increase in the 2004–2006 GDP growth estimates made via revisions to the national accounts in June 2007 generated an increase in the estimated rate of growth of the potential, non-accelerating inflation level of output.

**Table II.10 Fulfilment of the forecast for key variables**

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

| | | III/06 | IV/06 | I/07 | II/07 | III/07 | IV/07 |
|---|---|---|---|---|---|---|---|
| 3M PRIBOR | p | 2.5 | 2.9 | 3.1 | 3.5 | 3.9 | 4.2 |
| (percentages) | o | 2.4 | 2.6 | 2.6 | 2.8 | 3.3 | 3.8 |
| CZK/EUR exchange rate | p | 28.4 | 28.5 | 28.6 | 28.7 | 28.6 | 28.6 |
| (levels) | o | 28.3 | 28.0 | 28.0 | 28.3 | 27.9 | 26.8 |
| Real GDP a) | p | 6.5 | 5.6 | 4.9 | 4.8 | 5.2 | 5.4 |
| (annual perc. changes) | o | 6.3 | 6.1 | 6.4 | 6.0 | 6.1 | - |
| Inflation pressures | p b) | 0.6 | 0.3 | 0.2 | 0.3 | 0.3 | 0.3 |
| from the real economy | o c) | 0.2 | 0.4 | 0.6 | 0.8 | 0.8 | 0.8 |

p - prediction, o - outturn
a) seasonally adjusted
b) output gap as a percentage of GDP
c) real marginal cost gap; estimate based on the CNB's forecast from this Inflation Report

Based on the CNB's current knowledge of the workings of the Czech economy and its current knowledge of actual economic developments, the developments since the July 2006 forecast was drawn up can be summed up in the following way. The inflation pressures from the real economy have been positive since 2006 H2 and more pronounced compared to the July forecast (see Table II.10). Nevertheless, adjusted inflation excluding fuels was low over the entire period, as the exchange rate of the koruna began to have a strong anti-inflationary effect from 2006 Q4 onwards via lower import prices. A stronger koruna exchange rate and the introduction of a new consumer basket were the main reasons why headline inflation was below the July forecast for most of 2007. The surge in inflation in the last quarter was due to a sudden increase in food prices, fuel prices and regulated prices.

In addition to the message of the forecast itself, an assessment of the risks associated with this forecast is of importance for the Bank Board's decisions on monetary policy rates. At its meetings between April and December 2006 (see the relevant minutes) the Bank Board assessed the risks of the forecasts drawn up in the key period as being roughly balanced. This overall assessment was reflected in the monetary policy decisions of the CNB Bank Board, which were in line with the forecasts. With the benefit of hindsight, one can assess the interest rate settings in the key period as having been broadly appropriate. Although headline inflation was well above the inflation target in 2007 Q4, monetary-policy relevant inflation, which does not take into account the first-round effects of indirect tax changes and which is of key importance for the CNB's decision making, crossed over from below the inflation target into the upper half of the tolerance band in 2007 Q4.

## III.1 EXTERNAL ASSUMPTIONS OF THE FORECAST

*Since the previous forecast, the outlook for the external environment has shifted towards lower external demand and higher inflation. Except for 2008 Q1, the outlook for EURIBOR interest rates has fallen. The dollar-euro exchange rate path has been revised towards a weaker dollar over the entire forecast horizon. The expected path of oil and petrol prices has been moved significantly upwards.*

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 January Consensus Forecasts data and the market information effective on the survey closure 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 in the near term.

Effective GDP growth of 1.9% is expected for the euro area in 2008. This will increase slightly to 2.0% in 2009. The expected effect of external demand on the domestic economy is slightly anti-inflationary over the entire forecast horizon. Expected external inflation in the coming three quarters has increased owing to price shocks. Growth of 2.2% in the effective indicator of consumer prices in the euro area is thus expected in 2008. The forecast for 2009 remains unchanged at 1.8%. The outlook for the effective indicator of producer price inflation this year has also been revised upwards, to 2.4%, but lower growth of 1.8% is expected for next year.

The implied future interest rate path has been very volatile over recent months. One-year EURIBOR rates were higher in 2007 Q4 than predicted by the previous forecast. They are expected to fall to an average of 3.9% this year and then rise slightly to 4.0% in 2009. With the exception of the first quarter of this year, the markets expect lower interest rates than at the time the October forecast was prepared. The dollar-euro exchange rate path has been revised towards a weaker dollar over the entire forecast horizon. At the beginning of this year, the dollar should reach its trough against the euro and is then expected to firm gradually to USD 1.36 against the euro at the end of the forecast horizon.

The rise in oil prices at the end of last year is reflected in a marked shift in the market outlook for Brent crude oil prices. The forecast assumes a gradual decline in prices from their current values, which are around 25% higher than expected in October, to just below USD 90 a barrel in 2009. The expected path of petrol prices has likewise been moved upwards.

**Table III.1 Expected external developments**

**EURIBOR rates will fall this year and rise slightly next year**

(quarterly averages)

| | I/08 | II/08 | III/08 | IV/08 | I/09 | II/09 | III/09 |
|---|---|---|---|---|---|---|---|
| Brent crude oil prices (USD/barrel) | 94.5 | 92.1 | 91.3 | 90.5 | 89.7 | 89.0 | 88.4 |
| ARA petrol prices (USD/t) | 846.5 | 846.0 | 824.0 | 774.0 | 782.0 | 887.8 | 841.5 |
| GDP in euro area a) | 1.8 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Producer prices in euro area a) | 3.0 | 2.6 | 2.3 | 1.6 | 1.6 | 1.8 | 1.9 |
| Consumer prices in euro area a) | 2.7 | 2.4 | 2.1 | 1.6 | 1.5 | 1.8 | 2.0 |
| USD/EUR exchange rate | 1.47 | 1.47 | 1.46 | 1.43 | 1.40 | 1.39 | 1.37 |
| 1Y EURIBOR (in per cent) | 4.3 | 3.9 | 3.8 | 3.7 | 3.9 | 4.1 | 4.1 |

a) effective indicator; annual percentage changes

## III.2 INTERNAL ASSUMPTIONS OF THE FORECAST

*The forecast still assumes that the domestic economy is currently at the peak of the business cycle. This year it will be affected by restrictive fiscal policy. Compared to the previous forecast, the estimate of real equilibrium appreciation has been increased and the view of some economic mechanisms has been changed.*

The internal assumptions of the forecast include the outlook for the effects of domestic fiscal policy and assumptions regarding the equilibrium values of key macroeconomic variables. These assumptions, together with the assumptions made about the external environment, affect the estimate of the current position of the economy in the cycle and the message of the forecast. The CNB's view of the

workings of the economy, as described by the prediction model, also plays an important role in this estimate.

The new forecast takes into account the results of the state budget and other components of the public budgets in 2007, when better-than-expected results were achieved thanks mainly to higher tax revenues and to a year-on-year expenditure slowdown at the year-end. The deficit forecast under ESA 95 methodology has been decreased by around 1 percentage point for 2008 and 2009. A deficit of 1.5% of GDP is expected for 2008, reflecting the stabilisation measures adopted. In 2009, the impact of some of the stabilisation measures on public finances will unwind, and there will also be a further reduction of direct tax rates. Further austerity measures on the expenditure side have not yet been specified, so the assumption of an increase in the public finance deficit to 2.2% of GDP remains unchanged in the 2009 forecast. As in the previous forecast, the effect of fiscal policy on demand in the economy is expected to be restrictive in 2008 and, by contrast, expansionary in 2009. It still holds true that no sizeable additional fiscal stimulus is expected from EU fund inflows over the forecast horizon.

The current forecast revises the view of the equilibrium path of the real exchange rate. The rate of real equilibrium appreciation in the forecast is higher in particular for 2008, thus reflecting the specific nature of this year's appreciation of the real exchange rate through higher food price and regulated price inflation, which should not weaken the competitiveness of Czech exporters. The equilibrium real annual appreciation is estimated at 5% in 2008, before falling back below 4% in 2009. The increase in the real equilibrium appreciation rate was offset by a rise in the risk premium. Owing to the largely cost character of the current inflation, the forecast estimate for equilibrium real wage growth has also been reduced for 2008. The estimate for other equilibrium variables saw no major changes. Over the forecast horizon, the one-year domestic real equilibrium rate thus lies at 1% and the equilibrium real 1Y EURIBOR at 2%. The estimated rate of growth of the potential, non-accelerating inflation level of output lies between 5.0% and 5.5% both currently and over the forecast horizon.

An important factor for the message of the forecast is a change to the modelling system involving a shift towards a smaller effect of specific price shocks on headline inflation and towards a faster monetary policy reaction and faster transmission of that reaction to the economy. The main change is a shift in the view of price formation, as there will no longer be immediate pass-through of shocks across the individual price categories. A detailed description of the changes to the model is given in Box 4.

**BOX 4**
**Changes to the CNB's core prediction model**

During the preparation of this forecast, several major changes were made to the core prediction model, leading to a reduction in the long-term effect of specific price shocks on other price categories and to a faster monetary policy reaction and transmission.

The view of model price formation in individual price categories has been changed. According to past experience, major changes in regulated prices and energy prices have not passed through to other price categories as significantly and for as long as suggested by the original model. Therefore, the excessive impact of such fluctuations in the forecasts has been expertly reduced. The model in its present form systematically eliminates this excessive impact. This attempt to bring the model view closer into line with the

observed behaviour of the economy has resulted in a change to the model equations that describe the price formation mechanism and affect the speed of transmission. The result is reduced overall model rigidity and increased forward-lookingness of the model.

The change to the model affects the reaction function of the central bank and all equations influencing price formation. These include the inflation expectations and Philips curve equations. Although the assumption of the effect of inflation expectations of individual components on overall expectations remains unchanged, prices do not pass through immediately across the individual price categories. The forward-lookingness of inflation expectations for individual price categories has been increased slightly; in the case of regulated prices, inflation expectations are perfectly forward-looking. At the same time, the speed of the monetary policy reaction has been increased through reduced interest rate persistence in the reaction function.

The effect of the model changes on the forecast can be seen from the difference between the baseline scenario and the alternative scenario – see section III.3 *The message of the 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 estimated overall inflation pressures from the real economy in 2007 Q4 are inflationary, in line with the October forecast, and indicate that the economy is currently at the peak of the business cycle. However, the view regarding the impact of the two components is slightly different.

The output gap is more inflationary than forecasted. This mainly reflects the large rise in food price inflation, which, despite its significant cost character, probably also contains demand components. The revision of the GDP figures and the impact of the change to inflation expectations in the model on the revision of the setting of the interest rate component of the real monetary conditions in 2007 acted in the same direction. The inflationary pressures from the volume of production stem from the persisting open and positive output gap, amid GDP growth at roughly the potential output growth level. All components of private demand are contributing to the growth.

Contrary to expectations, the real wage gap, which has been anti-inflationary since 2005, remained open and slightly negative, since real wage growth slowed at the end of 2007 as a result of higher consumer price inflation and lower-than-forecasted nominal wage growth in the business sector in 2007 Q3.

Headline consumer price inflation at the end of 2007 was higher than expected by the October forecast. This deviation was due to prices of food and fuels, which were significantly affected by world prices of these commodities. At the same time, food price inflation was probably higher than would correspond to cost factors. The other components of inflation were in line with the forecast.

The settings of the real monetary conditions in 2007 Q4, which affect the future course of the business cycle, are assessed as being neutral to slightly tight overall. The interest rate component is slightly easy, whereas the exchange rate component is assessed as being slightly tight. In late 2007 and early 2008, there was a further

tightening of the exchange rate component of the monetary conditions as a result of the appreciation of the koruna's nominal exchange rate.

**Chart III.1 The impact of the real economy on inflation**

**The real economy will have an anti-inflationary effect as from 2008 Q2**

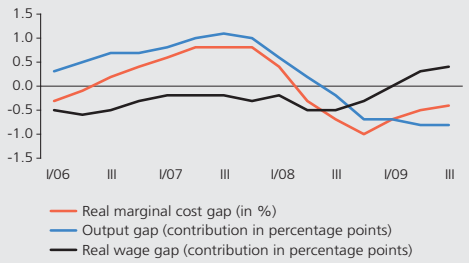



**Chart III.2 The GDP growth forecast**

**GDP growth will slow in 2008 and accelerate again in 2009**

(annual percentage changes)

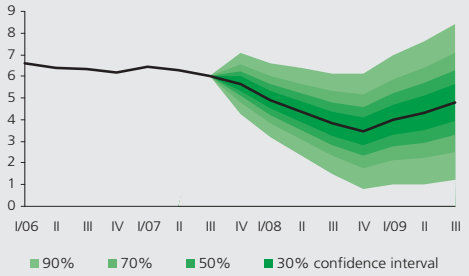



**Table III.2 Forecast of key GDP components**

**Growth in household consumption will slow this year**

(annual percentage changes)

| | 2007 | 2008 | 2009 |
|---|---|---|---|
| GROSS DOMESTIC PRODUCT | 6.1 | 4.1 | 4.6 |
| Household consumption | 5.5 | 2.8 | 4.3 |
| Government consumption | 0.5 | -1.0 | 0.7 |
| Gross fixed capital formation | 5.8 | 7.8 | 8.9 |
| Imports of goods and services | 13.4 | 10.1 | 10.9 |
| Exports of goods and services | 13.9 | 9.7 | 10.8 |
| Net exports of goods and services (in CZK bn; at constant prices) | 1.7 | -12.1 | -16.5 |

**Table III.3 Forecast of selected variables**

**The wage in the business sector will grow at around 9%**

(annual percentage changes)

| | 2007 | 2008 | 2009 |
|---|---|---|---|
| Real gross disposable income of households | 5.3 | 2.5 | 4.4 |
| Total employment | 2.0 | 1.2 | -0.4 |
| Unemployment rate (in per cent) a) | 5.3 | 4.3 | 4.6 |
| Labour productivity | 4.2 | 2.9 | 5.0 |
| Average nominal wage | 7.6 | 7.9 | 7.7 |
| Average nominal wage in business sector | 7.9 | 9.0 | 8.8 |
| Current account deficit (ratio to GDP in per cent) | -2.7 | -3.0 | -2.9 |
| M2 | 10.9 | 9.3 | 7.2 |

a) ILO methodology

## III.3 THE MESSAGE OF THE FORECAST

*The aforementioned information on domestic and external economic developments obtained since the October forecast, and the changes to the forecasting system, have changed the forecast for the Czech economy. The real economy will have an anti-inflationary effect as from 2008 Q2. Following an initial correction from its historical highs, the exchange rate of the koruna against the euro will gradually appreciate in 2008 and 2009. Inflation will rise sharply at the start of 2008, but decline steadily from 2008 Q2 onwards. The temporary effect of high food and regulated prices and indirect tax changes will then unwind in 2009, when inflation will slow significantly. Consistent with the macroeconomic forecast is a modest rise in nominal interest rates initially, followed by a decline still in 2008. In 2009, nominal interest rates are expected to be broadly flat.*

The effect of the real economy – captured by the real marginal cost gap – will remain inflationary at the start of this year but will quickly turn anti-inflationary as the year progresses. This effect will be maintained in 2009, albeit with falling intensity. The output gap and the real wage gap will affect inflation in opposite directions over most of the forecast horizon.

The first component of real marginal costs – the output gap – will close rapidly in 2008 owing to restrictive fiscal policy, slightly anti-growth external demand and slightly tight monetary conditions. Subsequently, it will decline further into negative figures. Its anti-inflationary effect will not subside even after the fiscal restriction unwinds in 2009, as the other anti-growth factors will persist. The forecast expects real GDP growth to slow to 4.1% this year and accelerate moderately to 4.6% in 2009.

A decline in the growth rate of household consumption due to fiscal and social measures and the rise in inflation will be an important factor slowing economic growth. Owing to a decrease in the growth rate of real disposable income, household consumption will rise by only 2.8% in 2008. In 2009, it will recover thanks to a fall in inflation, which will have a positive effect on real wage growth despite a downswing on the labour market. Household consumption growth will thus rise to 4.3%.

Investment demand will remain a source of economic growth in 2008 and 2009. Investment activity will be supported over the entire forecast horizon primarily by FDI inflows. In 2009, higher investment will also be fostered by corporate savings resulting from the tax reform. Gross fixed capital formation will thus grow by roughly 8% in 2008, and in 2009 the rate of growth will reach 9%.

The forecast still assumes a growth trend in export performance, connected with FDI inflow and related changes on the supply side of the economy. Owing mainly to a stronger real exchange rate, however, the forecast for real export growth has been lowered slightly for this year. The growth rate will be roughly 10% in 2008 and rise slightly to 11% in 2009 owing to slower real exchange rate appreciation. Real import growth will slow as a result of lower growth in domestic and export demand. However, it will marginally outpace export growth in both years. The downward revision of imports compared to the previous forecast reflects an expected fall in demand for imports for export industries.

The second component of the real marginal cost gap – the real wage gap – will be anti-inflationary in the remainder of this year despite a rapid rise in nominal wages

of around 9%. This is due to high inflation reducing real wages. Inflation will fall in 2009, resulting in an inflationary real wage gap amid an unchanged trend in nominal wages. The forecast expects unemployment to continue declining in 2008 and be flat or gradually rising in 2009.

Following a correction from its historical highs at the start of 2008, the exchange rate of the koruna against the euro will gradually appreciate over the next two years. This appreciation will be in line with the equilibrium real appreciation trend. However, it will be dampened by an increasing gap between expected domestic and foreign inflation and a gradually widening negative interest rate differential.

Compared to the October forecast, the forecast for headline inflation is much higher in 2008, but lower from the start of 2009. The effect of the unexpectedly high inflation outturns at the end of 2007 and the increased forecast for regulated prices – especially fees in health care and energy prices for households – will prevail at the start of the forecast horizon. After the base effect associated with these factors drops out, the effect of the lower forecasts for adjusted inflation excluding fuels and food price inflation will manifest itself. The revision of these components is due to a stronger exchange rate, a more anti-inflationary real economy and the changes to the model. The impacts of the tax changes in 2008 Q1, which were already included in the previous forecast, have also been partly revised. Judging from food price developments in 2007 Q4, the price increase relating to the VAT rate change has already partially materialised, so the expected impact on prices in 2008 Q1 is only small.

Inflation will continue to rise sharply at the start of 2008, but will decline steadily from 2008 Q2 onwards. The temporary effect of high food and regulated prices and indirect tax changes will then unwind in 2009, when inflation will slow significantly. With the exception of the immediate future, the real economy will subdue inflation. Import prices will act in the same direction. After the administrative effects unwind, inflation will fall towards the inflation target in 2009, and conditions will be created for hitting the new inflation target in 2010 (2%). At the monetary policy horizon, i.e. at the end of 2008 and in 2009 H1, headline inflation will initially lie slightly above the upper boundary of the inflation-target tolerance band and then drop slightly below the target.

Indirect tax changes (the VAT rate change and the harmonisation of excise duties and environmental taxes with EU rules) will affect inflation mainly in 2008. No tax changes are expected in 2009. At the monetary policy horizon, the first-round effects of indirect tax changes, to which the mechanism of caveats applies as usual, thus decline and have relatively little effect on annual inflation, disappearing completely as from 2009 Q2. At the monetary policy horizon, monetary-policy relevant inflation drops below the inflation target and approaches the new 2% target.

Consistent with the macroeconomic forecast and its assumptions is a modest rise in nominal interest rates initially, followed by a decline still in 2008. In 2009, nominal interest rates are expected to be broadly flat.

The baseline scenario of the forecast shows the most probable path of the economy from the CNB's point of view. The forecasts for the individual variables, however, are associated with numerous uncertainties. The fan chart illustrates the general uncertainty surrounding the forecast based on past forecast errors. The alternative scenario reflects a specific and currently pronounced risk that may play a significant role in monetary policy decision-making.

A relatively high degree of uncertainty is currently perceived regarding the modelling of the price-formation process. The question of whether adjusted inflation excluding fuels will remain low despite relatively high headline inflation

**Table III.4 Forecast of key inflation components**

**The impact of regulated prices and taxes on inflation will be significant in 2008**

(annual percentage changes; quarterly averages)

| | I/08 | II/08 | III/08 | IV/08 | I/09 | II/09 | III/09 |
|---|---|---|---|---|---|---|---|
| CONSUMER PRICES | 6.8 | 6.7 | 6.4 | 5.3 | 3.4 | 2.4 | 2.3 |
| Regulated prices a) | 13.1 | 13.7 | 13.8 | 13.1 | 6.2 | 5.1 | 4.8 |
| First-round impacts of indirect tax changes on consumer prices b) | 2.2 | 2.3 | 1.9 | 1.8 | 0.5 | 0.0 | 0.0 |
| Prices of food, beverages, tobacco c) | 5.5 | 5.8 | 6.2 | 3.5 | 4.6 | 3.6 | 2.9 |
| Adjusted inflation excl. fuels c) | 1.2 | 1.1 | 0.8 | 0.4 | 0.3 | 0.3 | 0.5 |
| Fuel prices c) | 16.1 | 8.6 | 8.6 | 9.3 | 9.3 | 9.2 | 9.0 |
| Monetary-policy relevant inflation d) | 4.6 | 4.4 | 4.4 | 3.4 | 2.9 | 2.4 | 2.3 |

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

**Chart III.3 The inflation forecast**

**At the monetary policy horizon, the inflation forecast initially lies slightly above the upper boundary of the inflation-target tolerance band and then drops slightly below the target**

(annual percentage changes)

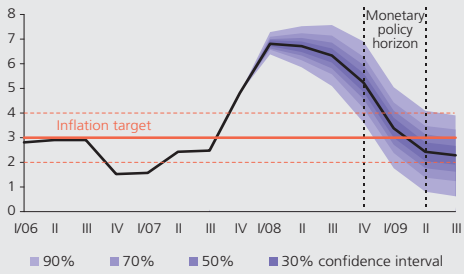



**Chart III.4 The monetary-policy relevant inflation forecast**

**At the monetary policy horizon, monetary-policy relevant inflation drops below the inflation target and approaches the new 2 per cent target**

(annual percentage changes)

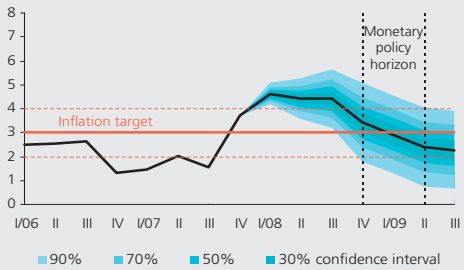



**Chart III.5 The interest rate forecast**

**Consistent with the macroeconomic forecast and its assumptions is a modest rise in nominal interest rates initially, followed by a decline still in 2008**

(3M PRIBOR, %)

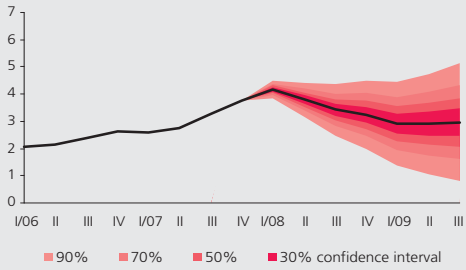


**CHART III.6 THE ALTERNATIVE INFLATION FORECAST**

**At the monetary policy horizon, headline inflation initially lies slightly above the upper boundary of the inflation-target tolerance band and then drops towards the target**

(annual percentage changes)

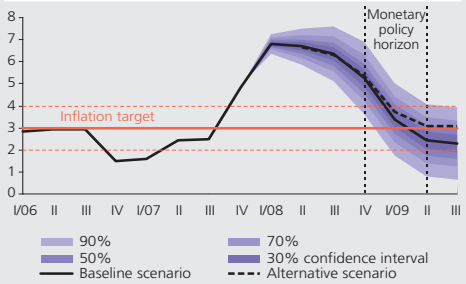



**CHART III.7 THE ALTERNATIVE INTEREST RATE FORECAST**

**Consistent with the alternative inflation forecast is a gradual rise in interest rates during 2008 followed by a slow decline**

(3M PRIBOR, %)

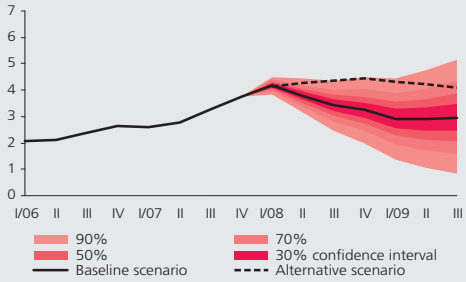



**TABLE III.5 INFLATION EXPECTATIONS**

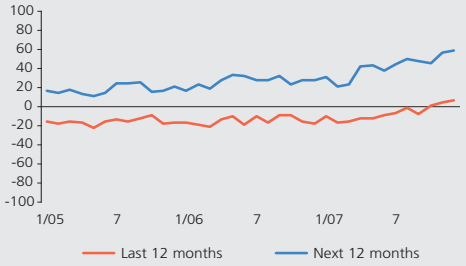
**Inflation expectations fluctuated above the CNB's target**

(percentages)

| | 12/06 | 9/07 | 10/07 | 11/07 | 12/07 |
|---|---|---|---|---|---|
| CONSUMER PRICES | | | | | |
| 1Y horizon: | | | | | |
| Financial market | 3.3 | 4.2 | 4.3 | 4.3 | 4.5 |
| Corporations | 3.0 | 3.6 | | | 4.9 |
| 3Y horizon: | | | | | |
| Financial market | 2.7 | 2.5 | 2.5 | 2.6 | 2.7 |
| Corporations | 2.9 | 3.4 | | | 3.8 |
| 1Y PRIBOR | | | | | |
| 1Y horizon: | | | | | |
| Financial market | 3.4 | 4.1 | 4.1 | 4.1 | 4.1 |

**CHART III.8 INFLATION INDICATORS**

**The indicators of perceived and expected inflation both increased in 2007 Q4**




Source: European Commission Business and Consumer Survey

continues to pose an upside risk to inflation in this price category. This risk is covered by an alternative scenario which returns to the model settings corresponding to the October forecast and assumes, among other things, that headline inflation immediately affects price formation in all price categories.

Administrative effects (increases in regulated prices and indirect taxes) and food and energy price shocks are the main driving forces of the inflation forecast for 2008. In the alternative scenario, this leads – via a higher headline inflation path – to pressure for faster growth in most other price categories. As the original model is highly persistent, adjusted inflation excluding fuels thus decreases only gradually in 2008. In the baseline scenario, the monetary policy tightening in response to the increase in prices, along with other anti-inflationary factors, will immediately slow adjusted inflation excluding fuels, whereas in the alternative scenario it is insufficient to suppress the effect of inflation expectations. The one-off factors will unwind in 2009 and inflation will return to the inflation-target tolerance band as the year progresses. At the monetary policy horizon, headline inflation initially lies above the upper boundary of the inflation-target tolerance band and then drops towards the target. It thus lies above the baseline scenario of the forecast.

The reaction of interest rates in the alternative scenario reflects higher persistence of the monetary policy rule and inflation expectations. Consistent with the alternative inflation forecast is a gradual rise in interest rates during 2008 followed by a slow decline, in response to the higher inflation outlook. The interest rate path lies significantly above the baseline scenario.

## III.4 EXPECTATIONS OF ECONOMIC AGENTS

*Expected inflation increased at both the one-year and three-year horizons in 2007 Q4. The indicators of perceived and expected inflation also rose.*

The CNB monitors the inflation expectations of the financial market and corporations at the one-year and three-year horizons by means of statistical surveys. In addition, it uses a qualitative assessment of past and future inflation by households collected as part of the European Commission Business and Consumer Survey (see Box 2 in the July 2007 Inflation Report).

Future inflation expected by financial market participants at the one-year horizon rose further. The main inflationary factors are expected to include food prices, increases in regulated prices and indirect taxes and demand-pull inflation pressures. Conversely, the strong koruna is expected to have an anti-inflationary effect. The inflation expectations of corporations also rose further above the CNB's 3% inflation target. At the three-year horizon, the inflation expectations of both the financial market and corporations were also above the 2% inflation target valid as from January 2010.

The indicator of perceived inflation turned positive in Q4. This means that households on average felt that prices tended to rise over the last 12 months. The indicator of expected inflation was also positive, i.e. the number of respondents who expected prices to increase more rapidly over the next 12 months than in the past exceeded the number of those who expected prices to stay the same. Both indicators increased in Q4.

In Q4, the interest rates expected by financial analysts were almost unchanged at all the monitored maturities. The interest rate path consistent with the aforementioned CNB forecast was slightly above the expectations of financial market analysts for the near future. By contrast, it was lower at the longer horizon.

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

A joint document of the Ministry of Finance of the Czech Republic and the Czech National Bank approved by the Government of the Czech Republic on 19 December 2007

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

Besides being required to harmonise their legislation with Articles 108 and 109 of the Treaty establishing the European Community and the Statute of the ESCB, EU Member States are required to achieve a high degree of sustainable convergence in order to join the euro area.

This is measured by the fulfilment of four convergence criteria: a high degree of price stability, as apparent from the rate of inflation; sustainability of the government financial position, as measured by the government deficit and government debt; exchange rate stability, as measured by movements in the exchange rate within the normal fluctuation margins of the ERM II system for two years without devaluation; and durability of convergence, as reflected in long-term interest rate levels.

The Czech Republic is obliged to take steps to be prepared to join the euro area as soon as possible. However, setting the date for joining the euro area is within the competence of the Member State and depends on its preparedness. Potential non-fulfilment of the convergence criteria has no direct consequences for the Czech Republic at present. The only exception is the criterion on the sustainability of public finances. The result of the failure to meet this criterion is that the Czech Republic has been in the excessive deficit procedure since 2004. Under the procedure, the European Commission regularly examines the fiscal development in the Czech Republic. In July 2007, it proposed that the EU Council in its ECOFIN formation should decide that the Czech Republic is failing to take sufficient steps to correct its excessive public finance deficit within the agreed time limit of 2008. As a result of this decision, a second recommendation was issued stating what steps the Czech Republic should take to meet this objective. The assessment also takes into account the preparedness of the Czech Republic to fulfil this recommendation.

### 1.1 ASSESSMENT OF FULFILMENT OF THE CONVERGENCE CRITERIA

The Czech Republic will very probably not fulfil **the criterion on price stability** in 2008. Inflationary shocks, in particular changes to indirect taxes connected with the reform of public finances and with harmonisation with EU law (a rise in the lower VAT rate, excise duty on cigarettes and the environmental tax), temporarily shift inflation above the likely future reference value of the criterion. After this one-off shock stemming from administrative measures subsides, inflation will return to the lower level observed in previous years.

The announced reduction of the CNB's inflation target for the national consumer price index (CPI) to 2.0%, with a tolerance band of ±1.0 p.p., from 1 January 2010 creates better conditions for the fulfilment of the price stability criterion beyond this horizon. At the same time it is desirable that no substantial inflationary changes hindering the fulfilment of the criterion be made to indirect taxes during ERM II participation.

The Czech Republic is not compliant with **the criterion on the sustainability of the government financial position**. The path of fiscal consolidation, which forms the basis of the updated Convergence Programme of the Czech Republic approved by the Government on 28 November 2007[1], will stabilise public finances and maintain the government deficit below 3% of GDP. However, it does not ensure a sufficient improvement in the structural characteristics of the budget, nor does it improve the sustainability of public finances. A sustainable reduction of the general government deficit below 3% will require not only adherence to the already approved fiscal rules (the fiscal targeting regime) and fulfilment of the medium-term spending frameworks, but also further reforms. Such reforms must prepare Czech public finances for the future challenges associated with the negative demographic changes. Therefore, the current period of favourable economic growth should be used to launch reforms addressing the long-term fiscal pressures, i.e. in those areas which will be hit hardest by the demographic changes, in particular reforms of the pension and health care systems.

The ratio of government debt to GDP has been stabilised for the near future, thanks mainly to rapid economic growth. However, if the necessary reforms fail to be implemented, the ratio can be expected to rise gradually in the long term. Not even a successful medium-term fiscal consolidation will be able to stabilise the government debt level in a sustainable manner if the fiscal system is not prepared for the expected effects of population ageing.

Formal assessment of **the exchange rate criterion** will only be possible after the Czech Republic joins ERM II and the related central parity for the koruna's exchange rate is announced. The fluctuations in the CZK/EUR exchange rate over the last few years have been smaller than the hypothetical band of ±15%. Nonetheless, the deviations from the average rate have been quite significant and the koruna has been showing an appreciation trend for some time. The definition of the criterion implies that its interpretation is not entirely clear. One can say, however, that the criterion should be satisfied in the future.

The Czech Republic is currently compliant with **the criterion on long-term interest rates** and no problems are expected in this area in the future.

### 1.2 ASSESSMENT OF ECONOMIC ANALYSES

Some improvements have occurred recently in the functioning of Czech economy. However, some of them are linked with the Czech economic cycle. No major changes have yet occurred in the functioning of fiscal policy and in the institutional setup on the labour market leading to a long-term improvement in the flexibility of the Czech economy. However, it is also fair to say that none of the areas under review saw a significant deterioration last year. In terms of the current preparedness to adopt the euro, the characteristics of the Czech economy can be divided into three groups.

First, **numerous economic indicators speak in favour of the Czech Republic adopting the euro, and some of them have done so for quite some time**. This group includes the high degree of openness of the Czech economy, its close trade and ownership links with the euro area, and the achievement of convergence of the inflation rate and nominal interest rates.

1 The Convergence Programme is based on the draft state budget for 2008 and the medium-term outlook for the state budget of the Czech Republic for 2009–2010, which the government has submitted to the Chamber of Deputies (the lower house of the Czech Parliament).

The second group includes **areas which, in terms of euro adoption in the Czech Republic, continue to pose a risk of macroeconomic costs, but which have shown some improvement in recent years**. The positive developments include accelerating real economic convergence in the Czech Republic, including further modest convergence of the price level towards that in the euro area, even though a significant difference in the price level persists. According to analyses conducted, the alignment of economic activity between the Czech Republic and the euro area appears to have recently slightly increased. However, these results are not yet sufficiently robust. In terms of alignment, the shift in the characteristics of the financial market closer to the euro area conditions, coupled with a high degree of banking system stability and a further partial improvement in the conditions for doing business, are also good things.

The third group contains the **areas which continue to be bottlenecks as regards the economy's flexibility and ability to adjust to shocks**. This group includes an insufficient stabilising role of public finances and a limited capacity for flexible adjustment in the labour market and partly also in the product market. The current public finance deficits are largely structural in nature and do not provide sufficient room for the possible stabilising effect of fiscal policy. Adoption of the euro will require changes on the expenditure side of public finances leading to a substantial reduction in the deficit. In the long run, it will also be necessary to ensure that demographic changes do not adversely affect fiscal policy effectiveness and the sustainability of public budgets. The ability of the Czech labour market to absorb shocks is essentially unchanged from last year and remains average by European comparison. The recent improvement in its performance is largely associated with the high rate of economic growth, but long-term and structural unemployment remain relatively high, while regional mobility and wage elasticity are on the low side. Recent positive developments include a halt in the growth in overall labour taxation and in the growth in the ratio of the minimum wage to the average wage. The tax and benefit system, however, continues to create a demotivating environment for the long-term unemployed in low-income families with children. Another problem is that the skills of the long-term unemployed do not meet the current needs of the corporate sector. The costs of terminating an open-ended employment contract after a short period of employment remain very high by international comparison.

### 1.3 CONCLUSIONS AND RECOMMENDATIONS

Based on the aforementioned analyses, the Ministry of Finance and the Czech National Bank agree that sufficient progress has yet to be made in laying the groundwork for euro adoption in order to allow a target date to be set for entry into the euro area. Therefore, in line with the Czech Republic's Updated Euro-area Accession Strategy (the "Strategy"), they recommend that the Czech Government should not set such a date for the time being.

The draft state budget for 2008 and the medium-term budget outlook for 2009–2010, which are based on the already passed Public Budgets Stabilisation Act, do not create conditions for a sustainable reduction of the general government deficit and for ensuring the long-term soundness of public budgets. No significant progress has been made either in the area of increasing the flexibility of the Czech economy, and in particular the labour market.

Setting the target date for entry into the euro area is thus subject to the implementation of further reforms of public finances, mainly in the area of mandatory expenditures, which will be hardest hit by the consequences of demographic changes. In line with the Strategy, it is necessary to continue with further reform efforts so that the public finance deficits decline by at least 0.5%

GDP a year, well below the value of the Maastricht convergence criterion, in a verifiable and sustainable manner. The target for the Czech Republic under the Stability and Growth Pact over the medium term is to achieve a structural general government deficit of no more than 1% of GDP by 2012. Further reforms are also necessary to increase the flexibility of the Czech economy, and in particular the labour market.

The recommendation not to set a target date for euro area entry yet simultaneously implies a recommendation that the Czech Republic **should not attempt to enter the ERM II during 2008**. In line with the Strategy, the length of stay in ERM II should be as short as possible. Consequently, the decision to join the mechanism cannot be made before the target date for euro adoption has been set.

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

The convergence criteria (price stability, public finance sustainability as measured by the government deficit and government debt, exchange rate stability, and convergence of long-term interest rates) are defined in the EC Treaty (the "Treaty") and specified in the Protocol on the Convergence Criteria and the Protocol on the Excessive Deficit Procedure annexed to the Treaty. Fulfilment of the convergence criteria in a sustainable manner is a necessary condition for adoption of the single currency by a Member State with a derogation.

### 2.1 CRITERION ON PRICE STABILITY

**BOX 2.1: DEFINITION OF THE CRITERION ON PRICE STABILITY**

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

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

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

The reference value relating to the values of "at most, the three best performing Member States in terms of price stability" is calculated in practice as the unweighted arithmetic average of the rate of inflation in the three

countries with the lowest inflation rates, provided that this rate of inflation is compatible with price stability.

**Implementation of the price stability criterion – current practice**
Both the Treaty and the Protocol in some areas leave scope for interpretation by the institutions that assess the fulfilment of the criteria. Therefore, when assessing the fulfilment of the criteria one should also take into account the specific way in which these institutions apply the criterion.

As the Convergence Reports published in 2004 have shown, the EC and the ECB somewhat differ in their specific interpretations of the phrase "best performing Member States in terms of price stability". Both institutions in these reports worked with the three countries with the lowest inflation (Finland, Denmark and Sweden) excluding Lithuania, which recorded an inflation rate of -0.2% in the reference period. However, the decision to exclude Lithuania was justified in slightly different ways in the two reports. For the Commission the reason was that Lithuania had shown negative inflation, whereas for the ECB it was that inflation in Lithuania over the reference period was judged to have been due to "the accumulation of specific factors"; in the ECB's opinion, including such factors in the calculation of the reference value might have distorted the reference value and reduced its usefulness as an economically meaningful benchmark.

Lithuania's application to enter the euro area, submitted in 2006, was rejected on the grounds that the country had narrowly failed to fulfil the inflation criterion and had an adverse inflation outlook. This example shows that the European authorities (the European Commission, the EU Council in its ECOFIN formation, and the ECB) apply a strict interpretation of the Maastricht convergence criteria and other conditions for the adoption of the euro when examining countries that have applied for the entry into the euro area. Their interpretation emphasises sustainable fulfilment of the economic criteria after euro adoption, above and beyond a purely legal view of the matter. If the outlook for the months immediately following the compilation of the Convergence Report foresees inflation rising above the reference value, the conclusion may be that the country is failing to satisfy the criterion in a sustainable manner. The fact that greater account of the sustainability of fulfilment of the criterion will be taken in the examination is also evidenced by recent statements made by the ECB and the Commission regarding the sustainability of the price developments in Slovakia.

If one bases the calculation of the reference value on the three EU countries with the lowest positive inflation (see Box 2.1), the Czech Republic has been compliant with the criterion on price stability since 2005. The criterion is also likely to be fulfilled for 2007 as a whole.

**Table 2.1: Harmonised index of consumer prices**
*(average for last 12 months vs. average for previous 12 months, growth in %)*

| | 2004 | 2005 | 2006 | 08/07 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|
| **Average for 3 EU countries with lowest inflation*** | 0.7 | 1.0 | 1.4 | 1.0 | 1.3 | 1.7 | 1.6 | 1.6 |
| **Reference value** (1st line +1.5 p.p.) | 2.2 | 2.5 | 2.9 | 2.5 | **2.8** | **3.2** | **3.1** | **3.1** |
| **Czech Republic** | 2.6 | 1.6 | 2.1 | 2.0 | **2.4** | **3.9** | **2.3** | **2.1** |

Source: Eurostat, European Commission, Convergence Programmes and Stability Programmes of Member States (2006), Convergence Programme of the Czech Republic (November 2007).

Note: The outlook for EU countries for 2007-2008 is taken from the European Commission's spring 2007 economic forecast.

* The three EU countries with the lowest positive inflation – see Box 2.1.

For 2008, however, it must be expected that the criterion will very probably not be fulfilled. Expected inflationary shocks will shift inflation temporarily above the CNB's current inflation target of 3% and will thus probably cause the reference value to be exceeded. In the current outlook, such shocks include changes to indirect taxes connected with the reform of public finances and with harmonisation with EU law, whose effect on consumer prices (as measured by the HICP) will exceed 1.6 percentage points next year[2] (a rise in the reduced VAT rate, excise duty on cigarettes and the environmental tax).

One also needs to take account of the possibility of higher inflation than forecasted by the Ministry of Finance of the Czech Republic. The current economic growth and the tax changes are generating increased uncertainty as regards the inflation forecasts and their spread. The CNB's outlook foresees HICP inflation around 5% in 2008 and roughly 3.5% in 2009. This implies that the criterion on price stability will very probably not be fulfilled in 2008, and fulfilment in 2009 is uncertain. However, after the one-off shock stemming from administrative measures and their secondary effects subsides, inflation should return to the lower level observed in previous years.

When assessing the future ability to maintain inflation below the reference value, one also needs to take into account that the individual countries' inflation forecasts, with few exceptions, do not deviate far from the ECB's definition of price stability, whereas actual developments have deviated from it significantly more in the past. This may mean a lower inflation level in the countries that form the basis for calculating the criterion, and thus a lower reference value. This was reflected in the criterion in previous years, when it was lower than in the outlook for the criterion given in Table 2.1. Moreover, the probability of a low reference value is higher than in the past, owing to the larger number of EU Member States, among which three countries with very low inflation will probably be found.

By contrast, a greater degree of certainty of future fulfilment of the criterion will be fostered by the announced reduction of the inflation target for the national CPI to 2.0%, with a tolerance band of ±1.0 p.p., from 1 January 2010. It is desirable, however, that no substantial inflationary changes hindering the fulfilment of the criterion be made to indirect taxes during the future participation of the Czech Republic in the ERM II.

## 2.2 CRITERION ON THE SUSTAINABILITY OF PUBLIC FINANCES [3]

### Government deficit criterion

The excessive deficit procedure against the Czech Republic was opened in 2004. On the commencement of the procedure by the ECOFIN Council, the Czech Republic agreed that it would bring its government deficit below 3% of GDP in a credible and sustainable manner by 2008. The Czech Republic's current public finance parameters prevent it from satisfying the government deficit criterion in a sustainable manner and ensuring the anti-cyclical operation of automatic fiscal stabilisers. The fiscal developments confirm that the decline in the deficit to, or just below, 3% GDP in 2004 and 2006 was largely due to higher-than-expected tax revenues. Moreover, given the fiscal expansion in 2007, the deficit is very likely to be higher this year (see Table 2.2).

2 The total contribution of administrative effects (i.e. changes to indirect taxes and regulated prices) to HICP growth in 2008 is estimated at 3.0 percentage points.

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

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

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

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

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

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

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

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

Being aware of the obligation to end the excessive deficit procedure in 2008, the government has pledged in its Programme Declaration to reduce the public finance deficit to 3.0% of GDP in 2008, 2.6% of GDP in 2009 and 2.3% of GDP in 2010 in order to meet the set time limit. The Public Budgets Stabilisation Act[4], involving amendments to 49 laws, is the first step. In addition to significant changes to the tax system, changes are being made to mandatory expenditures to reverse their current rising trend, to create room for a change in the structure of public expenditure and to stabilise public finances. This, along with other steps, has allowed the government to prepare and submit to the Chamber of Deputies (the lower house of the Czech Parliament) a draft state budget for 2008, which has been compiled in such a way as to reduce the total government deficit below 3% of GDP in 2008.

**Table 2.2: General government balance**
*(ESA 1995 methodology, in % of GDP)*

| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|
| **Reference value** | -3.0 | -3.0 | -3.0 | **-3.0** | **-3.0** | **-3.0** | **-3.0** |
| **Czech Republic** | -3.0 | -3.5 | -2.9 | **-3.4** | **-2.9** | **-2.6** | **-2.3** |

Source: CZSO, Government Deficit and Government Debt Notifications (October 2007), Convergence Programme of the Czech Republic (November 2007).

4 Act No 261 Coll. on the Stabilisation of Public Budgets, passed in the lower house of the Czech Parliament on 19 October 2007.

The draft medium-term budget outlook for 2009–2010 is also in line with the government's fiscal targets as set out in its Programme Declaration. The proposed path of fiscal consolidation will stabilise public finances and maintain the government deficit below 3% of GDP, although only provided that the current high economic growth rates are maintained and further cutbacks are implemented. However, it does not ensure a sufficient improvement in the structural characteristics of the budget such that there is no risk of exceeding the 3% threshold again in the event of a cyclical slowdown in growth, nor does it improve the sustainability of public finances. Consequently, it does not necessarily ensure that the excessive deficit procedure will be terminated in 2008. A sustainable reduction of the general government deficit below 3% will require not only adherence to the approved fiscal rules (the fiscal targeting regime and the medium-term expenditure frameworks), but also the adoption of further steps with regard to the Council's recommendations issued repeatedly for the Czech Republic (see Box 2.3).

**BOX 2.3: ECOFIN COUNCIL RECOMMENDATION TO THE CZECH REPUBLIC WITH A VIEW TO REDUCING THE EXCESSIVE DEFICIT, ADOPTED ON 9 OCTOBER 2007** [5]

When examining the Convergence Programme of the Czech Republic in July 2007, the ECOFIN Council concluded that the action taken by the Czech Republic was proving to be inadequate to correct the excessive budget deficit by 2008. Subsequently, on 9 October 2007, the ECOFIN Council adopted new recommendations for the Czech Republic, namely that:

1) The Czech Republic should further contain the budgetary deterioration in 2007 and put an end to the excessive deficit situation as rapidly as possible and by 2008 at the latest.

2) The Czech authorities should bring the general government deficit below 3% of GDP in a credible and sustainable manner. To this end, they should ensure an improvement in the structural balance (i.e. the cyclically-adjusted balance net of one-off and other temporary measures)* of at least 0.75% of GDP in 2008 compared to 2007.

In addition, the Council invited the Czech Republic to ensure that after the excessive deficit has been corrected, budget consolidation towards its medium-term objective for the budgetary position of a structural deficit of 1% of GDP is achieved by 2012 at the latest.

5 Treaty provisions – Excessive deficit procedure
The report prepared by the European Commission under Article 104 (3) of the Treaty should also take into account whether the government deficit exceeds government investment expenditure and all other relevant indicators, including the medium-term economic and budgetary position of the Member State. The Commission may prepare a report if, notwithstanding the fulfilment of the requirements under the criteria, it is of the opinion that there is a risk of an excessive deficit in a Member State. The Economic and Financial Committee formulates an opinion on the Commission's report.
In accordance with Article 104 (6) of the Treaty, the EU Council, on the basis of a recommendation from the Commission and having considered any observations which the Member State concerned may wish to make, decides, acting by qualified majority and following an overall assessment, whether an excessive deficit exists in a Member State. Under Article 104 (7) of the Treaty, the EU Council then makes recommendations to the Member State concerned with a view to bringing the deficit below the 3% level within a given period. If the Council, on a proposal from the Commission, decides that the respective Member State is failing to take action to correct the excessive deficit within the agreed time limit, the procedure is repeated.

The Council gave the Czech Republic a deadline of 9 April 2008 to take effective corrective action to reduce the deficit below 3% of GDP in a credible and sustainable manner in 2008.

* According to the calculations of the Czech Ministry of Finance, the structural deficit amounted to 3% of GDP in 2006 and increased to 3.7% of GDP the following year.

In the medium run, the Stability and Growth Pact implies that the Czech Republic should target a structural general government deficit of no more than 1% of GDP by 2012. However, given the current course for reducing the general government deficits, this target will not be hit until some later date. Therefore, the current period of favourable economic growth should be used to reduce the deficits more quickly. At the same time, reforms addressing the long-term fiscal pressures, i.e. in those areas which will be hit hardest by the demographic changes, in particular reforms of the pension and health care systems, should be launched without delay.

**Government debt criterion**

Given its low initial level of government debt, the Czech Republic has no problem fulfilling this criterion. The ratio of government debt to GDP has recently been stabilised successfully, thanks mainly to rapid economic growth (see Table 2.3). However, if the necessary reforms – particularly of the pension and health care systems – fail to be implemented, the ratio of government debt to GDP can be expected to rise gradually in the long term. Not even a successful medium-term fiscal consolidation will be able to stabilise the government debt level in a sustainable manner if the fiscal system is not prepared for the expected effects of population ageing.

**Table 2.3: General government debt**
*(ESA 1995 methodology, in % of GDP)*

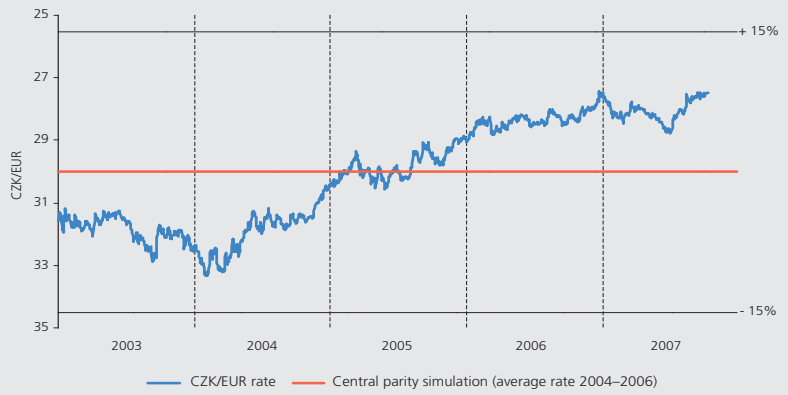
| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|
| **Reference value** | 60.0 | 60.0 | 60.0 | **60.0** | **60.0** | **60.0** | **60.0** |
| **Czech Republic** | 30.4 | 30.2 | 30.2 | **30.4** | **30.3** | **30.2** | **30.0** |

Source: CZSO, Government Deficit and Government Debt Notifications (October 2007), Convergence Programme of the Czech Republic (November 2007).

## 2.3 CRITERION ON EXCHANGE RATE STABILITY

The Czech Republic does not participate in ERM II, so the central parity of the CZK/EUR rate has not been set yet. For this reason, the exchange rate criterion cannot be formally assessed. In Chart 2.1, the hypothetical central parity is, for illustration, assumed to be the average of the daily rates for 2004–2006.

**Chart 2.1: Nominal CZK/EUR rate**




Source: CNB, Ministry of Finance calculations

Notes: In the chart, an upward movement in the exchange rate means an appreciation of the koruna
The hypothetical central parity is simulated by the average rate for 2004–2006..

The fluctuations in the CZK/EUR exchange rate over the last few years have been smaller than the hypothetical band of ±15%. Nonetheless, the deviations from the average rate have been quite significant and the koruna has been showing an appreciation trend for some time. The definition of the criterion implies that its interpretation is not entirely clear. In an attempt to reduce this ambiguity, the ECB published a statement in 2003 stating that the assessment of the fulfilment of this criterion would take into account also other factors than the exchange rate level alone (see Box 2.4). However, the assessment is not unambiguous even in the light of this statement. One can say, however, that the criterion on exchange rate stability should be satisfied in the future.

**BOX 2.4: DEFINITION OF THE CRITERION ON EXCHANGE RATE STABILITY**

**Treaty provisions**

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

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

**Application of Treaty provisions in ECB and EC Convergence Reports**

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

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

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

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

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

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

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

Successful ERM II participation may be aided in particular by a higher degree of convergence of the Czech economy, alignment of the Czech economy with the euro area economy and consistency of economic policies. The Strategy recommends participation in ERM II for the minimum required period of two years only. This implies that "the Czech Republic should enter the ERM II only after conditions have been established which enable it to introduce the euro at the time of the assessment of the exchange rate criterion (two years after entering the ERM II) and then to benefit from its introduction without experiencing any problems".[6]

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

6 For details, see the joint documents of the Czech Government and the CNB: "The Czech Republic's Euro-area Accession Strategy" and "The Czech Republic's Updated Euro-area Accession Strategy" at http://www.mfcr.cz/cps/rde/xchg/mfcr/hs.xsl/eu_acc_stra.html.

## 2.4 CRITERION ON LONG-TERM INTEREST RATES

### BOX 2.5: DEFINITION OF THE CRITERION ON LONG-TERM INTEREST RATES

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

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

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

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

The Czech Republic is currently compliant with the criterion on long-term interest rates and no problems are expected in this area in the future[7] (see Table 2.4).

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

| | 2004 | 2005 | 2006 | 08/07 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|
| **Average for 3 EU countries with lowest inflation** | 4.28 | 3.37 | 4.24 | 4.27 | 4.2 | 4.2 | 4.1 | 4.1 |
| **Reference value** (1st line + 2.0 p.p.) | 6.28 | 5.37 | 6.24 | 6.27 | **6.2** | **6.2** | **6.1** | **6.1** |
| **Czech Republic** | 4.75 | 3.51 | 3.78 | 4.03 | **4.4** | **5.1** | **4.5** | **4.6** |

Source: Eurostat, European Commission, Convergence Programmes and Stability Programmes of Member States (2006), Convergence Programme of the Czech Republic (November 2007).

Notes: The outlook for EU countries for 2006–2007 is taken from the European Commission's spring economic forecast.

7 As no forecast for the time horizon under review is available for the long-term interest rates of the countries that should, according to the inflation forecast, form the basis for calculating the criterion, the projection of the reference value in Table 2.4 for 2009 and 2010 is based on the technical assumption that long-term interest rates will move in line with inflation, i.e. real interest rates will not change. The future reference value should therefore be viewed as only tentative.

The forecast for interest rates on government bonds in the Czech Republic is dependent on the outlook for the CNB's monetary policy rates and particularly on successful implementation of the public finance consolidation. Any loss of financial market confidence in the outcome of the fiscal reform could very quickly lead to a rise in the risk premium on long-term interest rates and endanger the fulfilment of this convergence criterion.

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

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

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

The individual studies were drawn up using the statistical data and information available in September 2007. The analysis of the stabilising function of public budgets thus incorporates the estimated impacts of the fiscal reform approved in September 2007. However, the impacts of this reform on other areas (e.g. the impacts of changes to taxes and benefits on the financial incentive to keep or seek a job) have not been analysed.

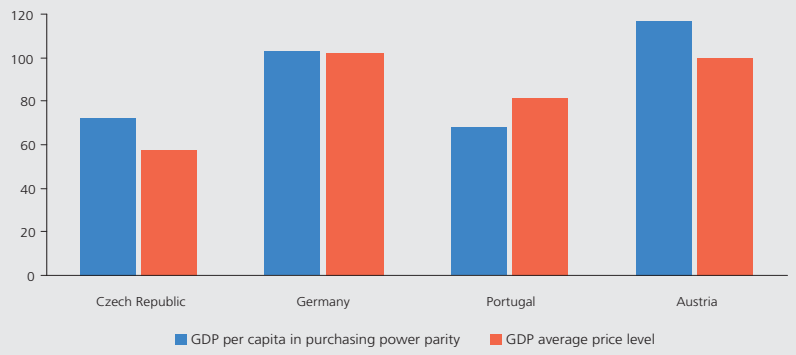
8 The selection of euro area countries included in the comparison comprises countries that are comparable in terms of economic level and countries with which the Czech economy has trading links. As in last year's document, the values of the indicators for the euro area are defined at the EA-12 level, since the time coverage of most of the analyses ends with 2006.

### 3.1 CYCLICAL AND STRUCTURAL ALIGNMENT

The costs arising from the loss of the Czech Republic's own monetary policy will be particularly pronounced if the Czech economy is not aligned with the euro area economy. The risks arising from the Czech Republic's accession to the euro area will decrease as the degree of alignment increases.

**The degree of real economic convergence** is an important indicator of similarity. A higher level of such convergence fosters greater similarity of long-run equilibrium development. Indirectly, it can also foster a lower likelihood of misalignment in the shorter run. A higher degree of convergence prior to ERM II entry and euro adoption should increase the relative price level, which will decrease potential future pressures for growth of the price level and equilibrium appreciation of the real exchange rate. Thanks to a pick-up in economic growth, GDP per capita in the Czech Republic has recently started to converge more quickly towards the euro area average. Its current level is comparable with the least advanced euro area countries (Portugal and Slovenia) and higher than in the other new EU Member States (see Chart 3.1). The price level also converged further in 2006, owing mainly to nominal appreciation of the exchange rate. However, the difference in the price level relative to the euro area, including its least advanced countries, remains sizeable. Moreover, the price level in the Czech Republic lies below the level which, according to empirical estimates, corresponds to the economic level. Besides a tendency towards a narrowing of this difference, we can also expect a continuing equilibrium trend of real appreciation of the koruna against the euro as a result of the ongoing process of real convergence. As before, prior to euro adoption this process will involve a decline in prices of tradable goods and a rise in prices of non-tradable goods, including regulated prices, amid low inflation overall. The persistence of this trend following accession to the euro area will initially engender a higher rate of inflation in the Czech Republic than in the euro area and, as a result, lower domestic real interest rates (probably even negative in the case of short-term money market rates). If this situation persists in the long term, there would be a risk of an overheating of the economy which could be associated with adverse consequences for macroeconomic and financial stability.

**Chart 3.1: Real economic convergence of selected states towards euro area in 2006**
*(EA-12 average = 100)*

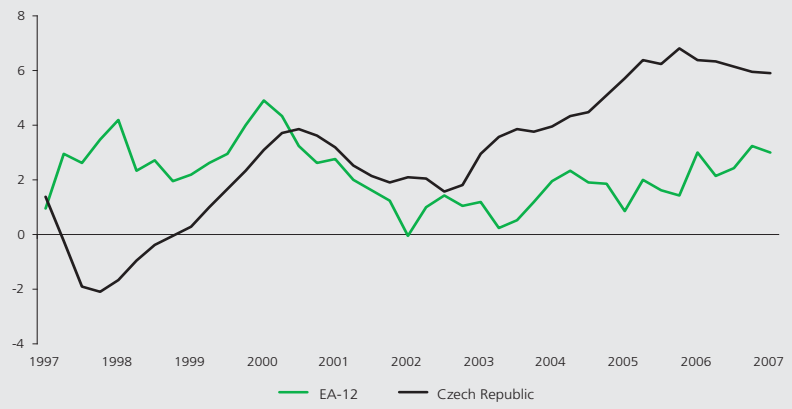



Source: Eurostat, CNB calculation.

**Alignment of economic activity and similarity of economic shocks** help the single monetary policy to have an effective and appropriate effect on an economy in a monetary union. The analyses suggest that the development of overall

economic activity in the Czech Republic may be converging towards that in the euro area (see Chart 3.2). However, the results are not unambiguous and this relationship may be partially distorted by the trend of the Czech economy. The observed correlations are meanwhile lower than in the other countries under review except Hungary. The analysis of the occurrence of demand-side and supply-side macroeconomic shocks does not find any alignment with the euro area. However, a relatively high degree of alignment with the euro area is observed for activity in industry. The results of analyses of export activity suggest the possibility of significant alignment between the Czech Republic and the euro area in this area, although these results are not robust. According to the analyses, however, the recent export activity of the Czech Republic is not statistically significantly correlated with GDP growth in the euro area. This may be linked with the integration of Czech exporters into the production chains of multinational companies.

**Chart 3.2: GDP growth in the Czech Republic and the EA-12**
*(in %, year on year)*




Source: Eurostat, CNB calculations.

Increased **drawdown of funds from EU structural funds** is a specific asymmetric shock that might impact on the Czech economy. Given a sufficient absorption capacity of the economy this could act as a considerable economic stimulus, materialising primarily in increased investment activity. However, the financial flows between the Czech Republic and the European Union have been very sluggish so far and the potential economic stimulus to domestic demand in this respect has shifted to 2008–2010 compared to the expectations in last year's analyses. The results of the analysis, however, indicate that this situation will not require a sizeable monetary policy reaction or a koruna exchange rate adjustment that would endanger the stay in ERM II or any assessment of the Maastricht exchange rate criterion. The financial flows between the Czech Republic and the EU can also be expected to affect the Czech public budgets. Overall, this effect will be slightly negative until 2008 and moderately positive thereafter.

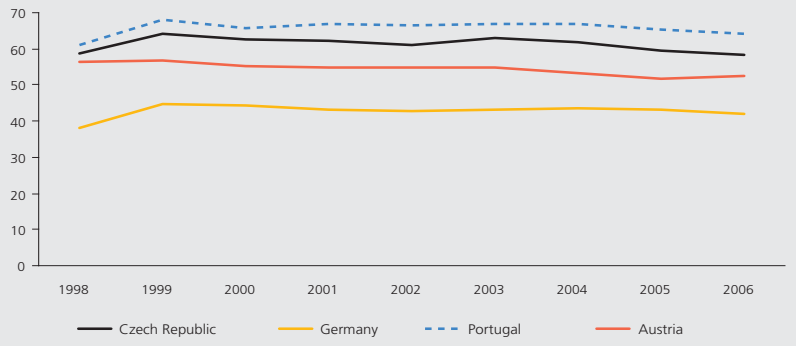
In terms of output generation, the Czech economy retains a specific feature in the form of a higher share of industry and a smaller share of certain services in GDP compared to the euro area.

Another asymmetric shock that has hit some economies in the past is rapid convergence of **nominal interest rates** ahead of entry into the monetary union. For a country planning to enter, earlier gradual convergence of such rates is therefore preferable. The difference between Czech interest rates and euro area

interest rates has been zero or negative since 2002. Although there is no guarantee that this situation will last until euro adoption, the effects of interest rate convergence when the Czech Republic joins the euro area can be expected to be generally small from the current perspective. The Czech koruna's **exchange rate** against the dollar has been moving very much in line with the euro's exchange rate against the dollar in recent years. This relationship loosened very slightly in 2007, mainly because of the increased volatility of the dollar's exchange rate. The macroeconomic characteristics of the Czech economy indicate potential for broadly similar or slightly lower medium-term exchange rate volatility than in the other new EU Member States compared. The observed medium-term volatility of the Czech koruna against the euro is lower than in the other monitored currencies of the new EU Member States in 2007.

The Czech economy's strong **trade and ownership links** with the euro area magnify the benefits arising from the elimination of potential fluctuations in the exchange rate. The euro area is the partner for approximately 60% of Czech exports and imports. Strong links are also apparent for the other economies under comparison (see Chart 3.3). The Czech economy's ownership links with the euro area on the direct investment inflow side are slightly stronger than in the other countries compared and are continuing to strengthen. The Czech economy's strong economic integration with the euro area creates conditions for increasing its economic alignment with this area. Another positive aspect from this perspective is the high intensity of intra-industry trade with the euro area, which is comparable with Austria and Germany.

**Chart 3.3: Exports to the EA-12 as a percentage of total exports**
*(%)*




Source: IMF, CNB calculations.

The analysis of the Czech **financial sector**, and, within it, the banking sector, reveals that despite its relatively small size by comparison with the euro area, it need not be expected to have a fundamentally different effect on the economy. The monitored indicators have recently recorded further slight convergence towards the euro area. The depth of financial intermediation in the Czech Republic is currently thus roughly one-third of the level in Germany, Austria and the euro area and 40% of that in Portugal. The Czech Republic lags behind these countries in particular in terms of lending. However, as a result of dynamic growth in loans to households and corporations in the Czech Republic, client loans are rising as a percentage of both total loans and GDP. On the one hand this trend represents gradual convergence towards the corresponding shares in the euro area, but on the other

hand it could pose a risk of loan defaults in the event of a further build-up in household debt. The historical experience of some current euro area countries with high growth in household borrowing suggests that such a trend does not necessarily lead to problems in the financial system, but less prudential assessment of client creditworthiness is a potential source of credit risk growth. The transmission of risk from the recent crisis on the US mortgage market has had a minimal effect on the Czech financial sector, thanks to the provision of mortgages on primary deposits, the issuing of mortgage bonds on high-quality claims, good collateralisation of mortgage loans and limited investment in bonds backed by subprime foreign mortgages.

The degree of the **integration of the Czech financial markets** (stock and bond markets) with the euro area markets is at a similar level as in the case of Portugal and Austria. The speed of elimination of shocks on the Czech stock market has recently increased. The degree of integration of the Czech money market with that in the euro area is at the level of Slovenia before it adopted the euro, whereas the degree of integration of the foreign exchange market with the euro area is at a slightly lower level for the Czech Republic than was the case for Slovenia before it joined the euro area.

### 3.2 ADJUSTMENT MECHANISMS

In the absence of independent monetary policy, the flexibility of the economy and its ability to adjust to shocks will be particularly important. The stabilisation function of public budgets, labour and product market flexibility and the ability of the financial system to absorb shocks will therefore be vital for smooth economic development.

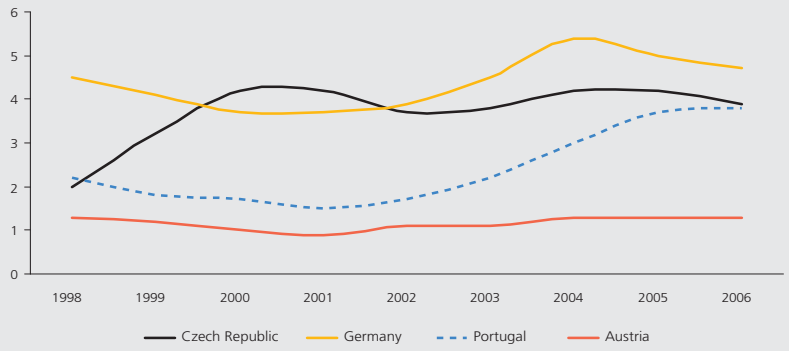
As regards **the public finances** of the Czech Republic, the effectiveness of the stabilisation function within the European fiscal regulations will be crucial. The Stability and Growth Pact commits the Czech Republic to steer towards achieving a structural (cyclically adjusted) public budgets deficit of no more than 1% of GDP in the medium term. The closer the deficit is to zero in its structural part, the more room there will be at a time of economic weakening for the functioning of automatic stabilisers and, in the extreme case, for the implementation of discretionary measures. The current public finance deficits, however, are largely structural in nature. The public finance deficit will rise again in 2007, at a time of solid economic growth. This is at odds with the effort to pursue anticyclical fiscal policy and with the commitment to consolidate public finances prior to introducing the euro. The adoption of fiscal stabilisation measures in September 2007 and their implementation in 2008, along with some other reform steps, may lead to a gradual improvement in this situation. The consolidation of public finances should also be accelerated in order to curb growth in nominal public debt, which would lead to increasing debt service costs. Another condition for maintaining fiscal policy effectiveness is to ensure public finance sustainability, especially by dealing with the effect of demographic changes on pension and health care system expenditures. The contribution of public finances to the economy's ability to respond flexibly to shocks will clearly be limited until these problems are tackled.

**Wage elasticity** can enhance the economy's ability to absorb shocks to which the single monetary policy cannot respond. The analyses indicate that real wage elasticity in the Czech Republic is currently low, just like in the other countries under comparison, and has decreased over time. Differences in **inflation persistence** in the countries of the monetary union may also imply different impacts of the single monetary policy. Inflation persistence in the Czech Republic is among the higher of the countries under comparison, but seems to be similar to that in Germany and Austria.

The ability of the Czech **labour market** to absorb shocks is virtually unchanged from last year and remains average by European comparison. The performance of the Czech labour market has recently seen some improvement. However, this improvement is largely associated with the high rate of economic growth observed since 2005. In some respects, though, the labour market is considerably less flexible than in the countries under comparison, and no major improvement is occurring. The institutional rules do not create the right conditions for employment of people with low skills. The main risk factors are the interaction of taxes and social benefits and the costs of terminating open-ended employment contracts.

The Czech labour market is still characterised by relatively high long-term and structural unemployment (see Chart 3.4), although the situation is rather better than in some other countries (Poland and Slovakia in particular). The Czech Republic still also has the largest regional differences in the unemployment rate. This may be due to significant regional gaps between the demand for, and supply of, labour and the low regional, occupational and sectoral mobility of the labour force, exacerbated, among other things, by the dominance of owner-occupied housing. It is thus reasonable to expect that cross-border mobility will probably not be an effective adjustment mechanism in the event of economic imbalances, even after movement of labour between the Czech Republic and all the original EU countries has been fully liberalised by 2011. Conversely, the inflow of foreign labour into the Czech Republic has recently been very dynamic, bearing witness to some degree of flexibility of the Czech labour market. On the other hand, however, it suggests that some serious problems persist in this market (in particular low incentives to seek employment for the long-unemployed with low skills), since the foreigners work mainly in jobs requiring few qualifications. The fact that movements of foreign workers are also going on in the wider context than just the Czech economy may pose some risk to labour supply, and might thus lead to unexpected changes with no links to the business cycle in the Czech Republic.

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




Source: Eurostat.

Labour market flexibility is determined to a great extent by the institutional rules. OECD analyses and some other new studies have revealed that collective bargaining has a fairly small effect on wage setting in the Czech Republic. The impact of the minimum wage on the flexibility of low wages and on job creation is also rather lower on average by international comparison. In addition, the halt in growth of the minimum wage as a percentage of the average wage can be

regarded as positive, since high minimum wages coupled with high labour taxation can have an adverse effect on job creation. Overall labour taxation in the Czech Republic decreased slightly in 2006. This decline was more marked in low-income categories. The effect of taxation on long-term unemployment and job creation is roughly the same as in Austria, Hungary and Poland, but higher than in Poland and Slovakia. Compared to other countries, the financial incentives to accept a job given by the combination of taxes and benefits in 2006 were comparable or higher for the short-term unemployed, but average for the long-term unemployed. Simulations showed no improvements associated with the reform of the social benefit system in 2007. The level of social benefits coupled with the tax burden may diminish efforts to seek or keep a job, particularly in households with children. In the area of permanent employment the Czech Republic ranks among the countries with a higher degree of job protection, which may present a risk in particular as regards the entry of young people to the labour market. By contrast, the gradual steps to simplify the procedures for setting up businesses are likely to positively affect job creation. Despite these partial improvements the **regulatory environment for doing business**, by international comparison, remains hampered by major administrative obstacles.

**Stability and effectiveness of the banking sector** is a precondition for the sector to be able to assist in absorbing the impacts of economic shocks. The percentage of non-performing loans in the Czech Republic has recently recorded an overall decline to a level only just above the euro area average. Capital adequacy is currently at a sufficient level comparable with the other countries monitored, but has been falling slightly over the past five years owing to the growing lending activity and the distribution of profits to bank owners. The sector's resilience is enhanced by its high profitability. Stress test results indicate that the Czech banking sector is stable and resilient to external shocks, although this resilience has yet to be tested by a period of adverse economic developments.

**MINUTES OF THE BOARD MEETING ON 29 NOVEMBER 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), V. Tomšík (Chief Executive Director)

The meeting opened with a presentation of the November situation report, which focused on assessing the newly available information and on its implications for the risks associated with the fulfilment of the October macroeconomic forecast. At 4% in October, annual consumer price inflation had been 0.2 percentage points higher than predicted by the October forecast. This deviation had been due to higher-than-expected growth in food prices. Accelerating food prices were the main upside risk to inflation now and for the months immediately ahead. However, the upside risks also included a higher outlook for regulated price inflation due to the planned healthcare reforms, a higher outlook for energy prices, and the magnitude of the second-round effects of the cost shocks linked with the rises in indirect taxes and regulated prices starting in January 2008. By contrast, the downside factors included a substantially stronger exchange rate, a slightly lower expected level of economic activity in the third quarter and an outlook of somewhat slower economic growth abroad. The overall risks of the forecast were assessed as being slightly on the downside, with the principal upside and downside risks diverging to either side rather significantly.

After the presentation of the situation report, the Board began its discussion. The board members agreed that both the upside and downside risks to inflation were quite significant, and a majority of the members felt that those risks had increased further since the previous situation report. The most extensively discussed upside factors were the accelerating food price inflation and the combination of energy price inflation, regulated price inflation and rising indirect taxes. The Board debated whether the observed growth in food prices was a short-term shock that would abate in the foreseeable future, or a long-term trend that might persist beyond the monetary policy horizon. Some of the board members expressed the view that food price forecasting is generally subject to extraordinary risk and questioned how far this factor should be taken into consideration in the decision-making. Other members, however, argued that the observed evolution of food prices should not be ignored, especially if it was going to foster a potential rise in inflation expectations.

In the context of the other upside risks to inflation, the Board discussed the extent to which the newly identified inflation pressures might materialise in the remaining months of 2007, i.e. before inflation starts to be sharply affected by the expected changes to regulated prices and indirect taxes resulting from the public finance reform. Many of the board members conceded the possibility that annual inflation would be higher in November and December than predicted by the October forecast, and drew attention to the risk of potential rapid adverse impacts on inflation expectations, even though those expectations seem quite well anchored in the long term.

The exchange rate featured prominently in the discussion of the downside risks to inflation. Some of the board members emphasised the fact that the rapid appreciation of the koruna in July had returned with renewed vigour in November. The discussion of the other downside risks focused on developments at home and abroad. Some of the board members expressed concerns about potential persistence of the adverse consequences of the mortgage crisis for the financial sector and about a possible future slowdown in euro area growth. A moderate risk of higher inflation abroad was also mentioned. Attention was given to signals of a possible modest downturn in domestic economic activity in the third quarter of 2007.

Another major topic discussed by the Board was the way in which economic agents are likely to form their inflation expectations in the period ahead. Some of the board members expressed concerns that the persisting tightness in the labour market may feed through to wage bargaining, which, in turn, might stimulate secondary inflation pressures and foster a slower fall in inflation in 2008. Some of the board members inferred from this that it was necessary to respond pre-emptively to the risk of rising inflation expectations. Although they conceded that the inflation pressures might ease in 2008, they regarded a pre-emptive response as necessary.

There were differences in opinion between the board members regarding the overall perception of the distribution of the individual upside and downside risks to inflation. However, all the board members agreed that the rise in prices in 2008 would be a one-off affair and that after it ended inflation would begin to head back towards the CNB's inflation target.

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 3.50%, effective 30 November 2007. At the same time it decided to increase the discount rate and Lombard rate by the same amount, to 2.50% and 4.50% respectively. Five members voted in favour of this decision, and two members voted for leaving rates unchanged.

**MINUTES OF THE BOARD MEETING ON 19 DECEMBER 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), V. Tomšík (Chief Executive Director)

The Board was presented with the December situation report, which analysed the new information and subsequently assessed the economic risks relating to the October forecast. According to the new situation report, the risks of the October forecast were balanced and their contrary effects were exceptionally strong.

At 5.0% in November, inflation had been 1.1 percentage points higher than predicted by the October forecast, mainly as a result of stronger-than-expected growth in the prices of food and fuels. In addition to accelerating prices of food and fuels, the outlook for regulated prices could be regarded as an upside risk to the October inflation forecast, owing chiefly to stronger growth in energy prices. Continuing appreciation of the koruna was an important downside risk of the forecast, exerting downward pressure on import prices and leading to tighter monetary conditions. The lower outlook for euro area economic growth and euro interest rates over the medium to long term acted in the same direction. GDP growth figures for the third quarter of 2007 had been significant new information. Economic growth of 6.0% had been only 0.1 percentage point lower than assumed in the October forecast. At the same time, GDP growth figures for the second quarter had been revised upwards. Data on GDP growth thus confirmed the assumption that the economy was expanding rapidly, albeit at a gradually decreasing pace.

After the presentation of the situation report, the Board discussed the new distribution of the risks relating to the October forecast and its implications for monetary policy. The Board agreed that the risks of the forecast were significant in both directions but roughly balanced overall. The discussion focused on the risks connected with the higher-than-forecasted inflation in November. There was consensus that inflation developments at the monetary policy horizon, which were surrounded by a higher degree of uncertainty than usual, were of key significance to considerations of monetary policy interest rate settings. Board members agreed that the current high level of inflation and the expected rise in inflation at the beginning of 2008 reflected mainly the build-up of one-off factors. The effects of these factors would start to unwind in 2008 and inflation would then return rapidly to lower levels. Further dampening of inflationary pressures would be aided by a slowdown in economic growth. Higher inflation caused by food and energy prices would result in slower growth in real disposable income which, in turn, would lead to a decline in the rate of increase of household consumer demand. The tightening of the exchange rate conditions would probably have a negative impact on the expansion of net exports.

The appreciation of the koruna, which was already acting towards a more pronounced decrease in import prices excluding food and fuels and whose effect might intensify in 2008, was identified as a significant downside risk to inflation. This risk could increase over time if the exchange rate remained strong. It was repeatedly emphasised that the evolution of the exchange rate during the preparation of the February forecast would be a very important indicator. The downside risks were also intensified by a less favourable economic outlook for the euro area and the United States. At the same time, the risks to this outlook were still skewed to the downside in connection with the large degree of uncertainty surrounding the impact of financial instability associated with the US mortgage market crisis.

It was discussed whether higher short-term market interest rates relative to the monetary policy rate reflected incorporation of expected monetary policy interest rate growth by market participants or the existence of liquidity and risk premia as currently observed on money markets abroad. In this context, an opinion was expressed that if higher market interest rates were connected with the aforementioned premia, further increases in the monetary policy rate might push money market rates to higher – and possibly inadequate – levels.

Given their substantial share in the current rise in inflation, food prices were an important subject of debate. Opinions were expressed that the current growth in world prices of food would come to a halt in 2008. This should be fostered mainly by the supply response to the increase in demand for agricultural products. It could also be assumed that the below-average harvest of 2007 would not repeat itself regularly in the years ahead. The Board agreed that the extent of the upside risk stemming from food prices could be lower than suggested by the November inflation figures. A hypothesis was discussed that the data on food prices in November had already

partly reflected the increase in the VAT rate effective from January 2008. This was supported by the fact that food price inflation in November was higher than in the neighbouring countries. Weekly survey data for the last two weeks indicated a halt in food price inflation in November. Therefore, it could be assumed that food prices would be flat or grow only moderately in the coming months. It was said that the recent increase in fuel prices had also been probably temporary, as it had been affected to a large extent by production capacity shortfalls and alternative imports. Growth in the prices of food and fuels would therefore be of a temporary nature overall and unwind at the monetary policy horizon. Adjusted inflation excluding fuels was also mentioned as a factor dampening the inflationary risks. Its current level was in line with the forecast, but if the prices of restaurant services related to food price inflation had been excluded, adjusted inflation excluding fuels would have been below the forecast in November.

Some of the board members stressed the upside risks to inflation, pointing out that a further pick-up in inflation owing to the increases in VAT and regulated prices might affect hitherto well-anchored inflation expectations, which would result in stronger second-round impacts on inflation. The build-up of price shocks, administrative measures and tax changes affecting items of everyday consumption at a single moment was identified as the source of these risks. Attention was also drawn to the strong industrial producer price inflation in October, the highest since April 2005. Against this, a counter-argument was expressed that a wage-price spiral stemming from rising inflation expectations could only materialise if high inflation prevailed for a longer period of time. Given the one-off nature of the current inflationary pressures, such a situation was unlikely to occur.

After discussing the situation report, the Board decided by a majority vote to leave the CNB two-week repo rate unchanged at 3.50%. Five members voted in favour of this decision, and two members voted for increasing rates by 0.25 percentage point.

**MINUTES OF THE BANK BOARD MEETING ON 7 FEBRUARY 2008**

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

The Board was given a presentation of the first situation report in 2008, containing in particular the new macroeconomic forecast. The new forecast responded among other things to changes in the external environment, where the financial market turbulence was starting to adversely affect the economic growth of the major global economies. The economic activity outlook for the euro area countries had been lowered. The monetary authorities' expected response had moved the Euribor interest rate outlook downwards. The fall in the Euribor had meanwhile been dampened by the ECB's fears of relatively high price index growth, the outlook for which had been revised upwards since the previous forecast. This high growth had been linked among other things with high prices of energy and fuels and with an upward revision of the outlook for oil prices by as much as $25 a barrel. From the point of view of the European economy, this rise had been only partially moderated by the depreciation of the USD/EUR exchange rate.

The starting conditions of the forecast assumed comparatively strong demand-pull inflation pressures from the real economy, stemming primarily from the positive output gap. Real wages were again slightly anti-inflationary. The real monetary conditions index was slightly easy in its interest rate component and tight in its exchange rate component. During 2008, the forecast assumed that the demand-pull inflation pressures would fairly quickly disappear and turn anti-inflationary. This was linked with projected lower output growth in both 2008 and 2009, chiefly reflecting lower private consumption and lower net exports. Tighter monetary conditions would also have an anti-inflationary effect.

The new forecast had also taken into account the higher-than-expected rise in inflation in late 2007, which it assessed as a one-off shock linked mainly with external developments. The underlying factors had been higher growth in food prices, fuel prices and regulated prices. A higher-than-usual contribution of changes to indirect taxes would be a factor at the short end of the forecast. The prediction assumes that this shock would fade relatively quickly as the demand-pull inflation pressures subside and the monetary conditions get tighter. The inflation forecast was thus initially above the previous forecast for most of 2008 and then declining towards the target at the monetary policy horizon.

Consistent with the macroeconomic forecast and its assumptions was a modest rise in nominal interest rates initially, followed by a decline still in 2008. In 2009, nominal interest rates were expected to be broadly flat.

Several major changes had been made to the core prediction model used to prepare the forecast. These had affected the paths of inflation, gross domestic product and implied interest rates. The main model change had consisted in limiting the pass-through of shocks across individual price categories. In addition, the weight of future developments in the formation of expectations and the flexibility of the monetary policy reaction had both been increased. In connection with these changes, an alternative forecast scenario – assuming the same model mechanisms as in the previous model from the 10th situation report of 2007 – had been prepared. This alternative scenario generated a higher inflation path than the baseline scenario of the forecast. Consistent with the alternative inflation forecast was a higher – and gradually rising – interest rate path during 2008 as compared to the baseline scenario, in response to this higher inflation outlook.

After the presentation of the situation report, the Board discussed the risks and uncertainties associated with the new forecast. The Board agreed that the uncertainties associated with monetary policy decision-making were this time greater than usual, while the risks were heading in both directions. These risks were linked with developments in both the global and domestic economies. The Board turned its attention to the high inflation recorded towards the end of last year. There was a consensus that the rise in prices had been caused by one-off shocks beyond the reach of monetary policy, which were gradually abating. In this context it was also said that monetary policy should focus on the future evolution of prices and not react to past inflation, which had been due in part to administrative changes introduced on 1 January 2008.

In the context of the observed high growth in prices, the Board also emphasised the uncertainties surrounding the possible higher pass-through of cost shocks to other price categories. It was said that a possibility of such second-round effects could be identified, for example, in the rise in measured inflation expectations. Some of the board members said in this regard that they had slight preference for the alternative scenario over the baseline scenario. But it was also said that the baseline scenario and the alternative scenario were predicting similar interest rate paths for the first quarter. Relatively significant differences between them emerge as from the second quarter. Some of the board members emphasised their aversion to contrary movements in interest rates in the short term as assumed in the baseline scenario of the forecast. It was said that raising interest rates in the short term cannot influence inflation or inflation expectations and would merely lead to needless volatility in the financial markets and the real economy. Other board members expressed the opposite opinion, stressing the need for flexible monetary policy.

Some of the board members expressed doubts about the sharp downswing in Czech economic growth predicted in the forecast. It was said that the related rapid change in the cyclical position of the economy was not all that usual, nor was it currently supported by the relatively favourable labour market data and other related economic indicators. Against this, it was argued that the previously mentioned slowdown in global economic activity, which might turn out to be far more significant than forecasted, might adversely affect the economic growth of the Czech Republic. The argument was also made that even at a time of rising prices and concurrently slowing economic activity, the central bank should be responsible primarily for price stability. It was also said that from the viewpoint of the Czech economy the global situation could be regarded as an example of an asymmetric shock.

Other potential impact channels on the Czech economy were also mentioned in the discussion of the considerable uncertainty surrounding the future course of the US economy and the Czech Republic's main trading partner economies. The possibility of significantly lower interest rates in the euro area was discussed in the context of the recent dramatic interest rate reduction in the USA. Other things being equal, such lower rates would foster a narrowing of the interest rate differential between the koruna and the euro and put appreciation pressures on the koruna's exchange rate. The slowdown in global economic activity might also lead to some easing of the demand pressures on world prices of food and oil, which in the recent past had risen sharply and had thus contributed to the cost shock to Czech prices. This shock might therefore fade more quickly than forecasted, especially as regards food prices and fuel prices. On the other hand, it was said that the previous rise in global prices of food and oil had been caused by adverse supply-side factors and by increased demand from the rapidly growing Asian economies, for which high demand could be expected to persist.

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 3.75%, effective 8 February 2008. At the same time it decided to increase the discount rate and Lombard rate by the same amount, to 2.75% and 4.75% respectively. Five members voted in favour of this decision: Governor Tůma, Vice-Governor Niedermayer, Vice-Governor Singer, Chief Executive Director Hampl and Chief Executive Director Tomšík. Two members voted for leaving interest rates unchanged: Chief Executive Director Holman and Chief Executive Director Řežábek.

| | |
|---|---|
| ARA | Amsterdam-Rotterdam-Antwerp |
| BCPP | Prague Stock Exchange |
| ČMZRB | Czech-Moravian Guarantee and Development Bank |
| CNB | Czech National Bank |
| CPI | consumer price index |
| CZK | Czech koruna |
| CZSO | Czech Statistical Office |
| ECB | European Central Bank |
| ECOFIN | Council of EU Ministers |
| EMI | European Monetary Institute |
| ERM II | Exchange Rate Mechanism |
| ESA 95 | European System of National Accounts |
| ESCB | European System of Central Banks |
| EU | European Union |
| EUR | euro |
| EURIBOR | Euro Interbank Offered Rate |
| FDI | foreign direct investment |
| Fed | US central bank |
| 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 |
| Ifo | Institute for Economic Research |
| ILO | International Labour Organization |
| IMF | International Monetary Fund |
| IRS | interest rate swap |
| LFS | Labour Force Survey |
| M1, M2 | monetary aggregates |
| MFIs | monetary financial institutions |
| MNB | Hungarian National Bank |
| MLSA | Ministry of Labour and Social Affairs |
| NBP | National Bank of Poland |
| NBS | National Bank of Slovakia |
| NCG | net credit to government |
| NDAs | net domestic assets |
| NEAs | net external assets |
| NPISHs | non-profit institutions serving households |
| OECD | Organisation for Economic Co-operation and Development |
| 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 |
| RMSE | Root Mean Square Error |
| SFAOs | state financial assets operations |
| SITC | Standard International Trade Classification |
| SKK | Slovak koruna |
| USD | US dollar |
| VAT | value added tax |
| ZEW | Centre for European Economic Research |

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|---|---|---|
| **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 |
| **The Balassa-Samuelson effect** | (Annex) | April 2002 |
| **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 CNB has fully integrated into the European System of Central Banks** | (Annex) | July 2004 |
| **The exchange rate in the CNB's forecasting system** | (Box) | July 2004 |
| **Indicators of households' financial situation** | (Box) | October 2004 |
| **GDP data revision** | (Box) | October 2004 |
| **Petrol prices and their impact on inflation in the Czech Republic** | (Box) | October 2004 |
| **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 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 |
| **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 |

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|---|---|---|
| **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 |
| **The causes, course and impacts of the current turmoil in global financial markets** | (Box) | October 2007 |
| **Household debt by income group in 2006 and its impact on consumption** | (Box) | October 2007 |
| **The causes of the sharp growth in world prices of cereals** | (Box) | October 2007 |
| **Fiscal measures and their impact on the economy in 2008** | (Box) | October 2007 |
| **The Czech Republic's updated euro-area accession strategy** | (Annex) | October 2007 |
| **Changes in the conduct and communication of monetary policy** | (Box) | January 2008 |
| **Publication of the forecast-consistent interest rate path and the use of fan charts** | (Box) | January 2008 |
| **The quarterly financial accounts statistics – New statistics at the CNB** | (Box) | January 2008 |
| **Changes to the CNB's core prediction model** | (Box) | January 2008 |
| **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 2008 |

This glossary explains some terms frequently used in the Inflation Report. A more detailed glossary can be found on the CNB website (www.cnb.cz/cs/obecne/slovnik/index.html).

**Adjusted inflation excluding fuels:** The increase in prices of non-food items of the consumer basket excluding items with regulated prices, indirect tax changes and fuels.

**Balance of payments:** Records economic transactions with other countries (i.e. between residents and non-residents) over a particular period. The basic structure of the balance of payments includes the current account, the capital and financial accounts and the change in CNB international reserves.

**Consensus Forecasts:** A regular monthly publication issued by Consensus Economics bringing together the forecasts of hundreds of prominent economists and analytical teams regarding future world developments. The CNB uses these predictions in its macroeconomic forecast when forming assumptions regarding the future development of the external environment.

**Current account:** Records exports and imports of goods and services, income from capital, investment and labour and unrequited transfers.

**Discount rate:** A monetary policy rate which as a rule represents the floor for short-term money market interest rates. The CNB applies it to the excess liquidity which banks deposit with the CNB overnight under the deposit facility.

**Disinflation:** A decline in inflation

**Effective euro area indicators:** Proxy for the effect of economic activity (effective GDP) and inflation (effective producer prices and consumer prices) in the euro area on the Czech economy. The weights used in the calculation are the shares of the individual euro area economies in the foreign trade turnover of the Czech Republic.

**Effective exchange rate:** Shows the appreciation (index > 100) or depreciation (index < 100) of the national currency against a basket of selected currencies for a certain time period relative to a base period. The weights applied in the basket are the shares of major trading partners in foreign trade turnover.

**Escape clause:** Excuses the central bank from its obligation to hit the inflation target. In the flexible inflation targeting regime, it is applied in the event of large shock changes in exogenous factors (particularly supply-side shocks, e.g. indirect tax changes) that are completely or largely outside the purview of central bank monetary policy.

**Euro area:** The territory of all Member States of the European Union that have adopted the euro as a single currency pursuant to the *Treaty Establishing the European Community*.

**Financial account:** Records transactions connected with the creation, liquidation and change in ownership of the financial assets and liabilities of the government, the banking and corporate sectors and other entities vis-à-vis the rest of the world. It consist of direct investment, portfolio investment, other investment and financial derivatives transactions.

**Fiscal impulse:** Captures the effect of domestic fiscal policy on economic demand.

**Food prices:** In CNB documents, the term food prices refers to the consolidated category of prices of food and non-alcoholic beverages and prices of alcoholic beverages and tobacco.

**Gross domestic product (GDP):** The key indicator of economic development. It represents the sum of the value added by all economic sectors. In terms of use it consists of expenditure on final consumption (consumption of households, the government and non-profit institutions), gross capital formation (fixed investment and changes in inventories) and foreign trade (net exports of goods and services).

**Inflation rate:** The increase in the average (basic) consumer price index for the last 12 months relative to the average for the previous 12 months.

**Inflation target:** The level of consumer price inflation that the CNB endeavours to achieve, set publicly and well in advance.

**Inflation:** Commonly, inflation is considered to be recurring growth of most prices in the economy. It means a decrease in the real value (i.e. purchasing power) of a given currency relative to the goods and services which consumers buy – if there is inflation in the economy, consumers need ever more currency units of the given country to buy the same basket of goods and services. In practice, inflation is measured by the increment of the consumer price index.

**Lombard rate:** A monetary policy interest rate which provides a ceiling for short-term interest rates on the money market. The CNB applies it to the liquidity which it provides to banks overnight under the lending facility.

**Monetary aggregates:** Represent the amount of money in the economy covered in the monetary survey. According to the national definition, they are calculated from the monetary liabilities of resident monetary financial institutions to other resident sectors (households, non-financial corporations and financial institutions excluding general government). Monetary aggregates differ according to the degree of liquidity of the individual components. The narrow monetary aggregate M1 comprises currency in circulation and overnight deposits. The broad monetary aggregate M2 comprises M1 plus deposits with agreed maturity, deposits redeemable at notice and repurchase agreements.

**Monetary conditions:** Represent the combined effect of interest rates (the interest rate component of the monetary conditions) and the exchange rate (the exchange rate component) on the economy. These are the key variables through which monetary policy can affect economic activity and, through it, inflation. In a period of easy monetary conditions monetary policy has been set in such a way as to support economic growth. If, conversely, monetary policy suppresses growth, we speak of a period of tight monetary conditions. Finally, in the case of neutral monetary policy settings, the monetary conditions are also termed neutral. The components of the monetary conditions do not necessarily affect the economy in the same direction.

**Monetary policy horizon:** The time horizon which monetary policy-makers focus on when making decisions and which takes into account the monetary policy transmission lag. This horizon is about 12–18 months ahead.

**Monetary policy interest rates:** Short-term interest rates associated with monetary policy-making. They comprise the two-week repo rate, the discount rate and the Lombard rate.

**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.

**Money market:** The part of the financial markets which is used to obtain short-term loans and where debt instruments maturing in less than one year are traded. T-bills are typical securities traded on this market. Within this market the CNB carries out its repo operations.

**Nominal unit labour costs:** The labour costs needed to produce a unit of output. Nominal unit labour costs are calculated as the ratio of the nominal volume of wages and salaries to GDP at constant prices.

**Real marginal cost gap:** Approximation of inflationary pressures from the real economy. Marginal costs consist of the costs arising from the increasing volume of production (the "output gap") and wage costs (the "real wage gap"). A positive real marginal cost gap implies an inflationary effect of the real economy and a negative gap implies an anti-inflationary effect.

**Regulated prices:** A sub-category of the consumer basket consisting of items with price ceilings (set at either central or local level), prices regulated on a cost-plus basis (items whose prices may only reflect economically justified costs and a reasonable profit) and administratively fixed fees. The selection of these items is based on the Price Bulletin of the Czech Ministry of Finance.

**Repo rate:** The CNB's key monetary policy rate, paid on commercial banks' excess liquidity as withdrawn by the CNB in two-week repo tenders.

**Unemployment rate:** The ratio of the number of unemployed persons to the total labour force. We distinguish between the general unemployment rate, as determined by the CZSO according to International Labour Organisation methodology, and the registered unemployment rate, as determined by the Ministry of Labour and Social Affairs.

**Table 1**

## KEY MACROECONOMIC INDICATORS

| | | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **DEMAND AND SUPPLY** | | | | | | | | | | | | | | | | |
| *Gross domestic product* | | | | | | | | | | | | | | | | |
| GDP | CZK bn, constant p. | 2,033.7 | 2,115.6 | 2,100.1 | 2,084.2 | 2,112.1 | 2,189.2 | 2,242.9 | 2,285.5 | 2,367.8 | 2,474.0 | 2,631.7 | 2,799.0 | **2,969.9** | **3,092.2** | **3,234.9** |
| GDP | %, y-o-y, real terms | - | 4.0 | -0.7 | -0.8 | 1.3 | 3.6 | 2.5 | 1.9 | 3.6 | 4.5 | 6.4 | 6.4 | **6.1** | **4.1** | **4.6** |
| Household consumption | %, y-o-y, real terms | - | 8.4 | 2.2 | -0.8 | 2.8 | 1.3 | 2.3 | 2.2 | 6.0 | 2.9 | 2.3 | 5.4 | **5.5** | **2.8** | **4.3** |
| Government consumption | %, y-o-y, real terms | - | -0.9 | 3.0 | -1.6 | 3.7 | 0.7 | 3.6 | 6.7 | 7.1 | -3.5 | 2.2 | 0.0 | **0.5** | **-1.0** | **0.7** |
| Gross fixed capital formation | %, y-o-y, real terms | - | 9.9 | -5.7 | -0.9 | -3.3 | 5.1 | 6.6 | 5.1 | 0.4 | 3.9 | 2.3 | 5.5 | **5.8** | **7.8** | **8.9** |
| Exports of goods and services | %, y-o-y, real terms | - | 5.5 | 8.4 | 10.4 | 5.4 | 16.5 | 11.2 | 2.1 | 7.2 | 20.7 | 11.8 | 14.4 | **13.9** | **9.7** | **10.8** |
| Imports of goods and services | %, y-o-y, real terms | - | 12.1 | 6.9 | 8.3 | 4.9 | 16.3 | 12.8 | 5.0 | 8.0 | 17.9 | 5.0 | 13.8 | **13.4** | **10.1** | **10.9** |
| Net exports | CZK bn, constant p. | -23.5 | -85.2 | -76.5 | -61.7 | -59.7 | -66.1 | -96.7 | -146.4 | -170.5 | -153.7 | -21.8 | -11.7 | **1.7** | **-12.1** | **-16.5** |
| *Coincidence indicators* | | | | | | | | | | | | | | | | |
| Industrial production | %, y-o-y, real terms | - | - | - | - | - | - | 6.7 | 1.9 | 5.5 | 9.6 | 6.7 | 11.2 | - | - | - |
| Construction output | %, y-o-y, real terms | 8.5 | 5.3 | -3.9 | -7.0 | -6.5 | 5.3 | 9.6 | 2.5 | 8.9 | 9.7 | 4.2 | 6.6 | - | - | - |
| Retail sales | %, y-o-y, real terms | - | - | -0.8 | -6.8 | 2.9 | 4.3 | 4.5 | 3.0 | 4.9 | 2.5 | 4.0 | 6.5 | - | - | - |
| **PRICES** | | | | | | | | | | | | | | | | |
| *Main price indicators* | | | | | | | | | | | | | | | | |
| Inflation rate | %, end-of-period | 9.1 | 8.8 | 8.5 | 10.7 | 2.1 | 3.9 | 4.7 | 1.8 | 0.1 | 2.8 | 1.9 | 2.5 | 2.8 | **6.3** | **2.6** |
| Consumer Price Index | %, y-o-y end-of-period | 7.9 | 8.6 | 10.0 | 6.8 | 2.5 | 4.0 | 4.1 | 0.6 | 1.0 | 2.8 | 2.2 | 1.7 | 5.4 | **4.9** | **2.3** |
| Monetary-policy inflation (excl. tax changes) | %, y-o-y, end-of-period | 8.0 | 8.3 | 10.1 | 6.7 | 1.6 | 4.4 | 4.2 | 0.6 | 0.8 | 2.2 | 2.4 | 1.3 | 4.3 | **3.1** | **2.3** |
| Regulated prices (16.40)** | %, y-o-y, end-of-period | 10.1 | 13.8 | 22.7 | 20.3 | 4.2 | 7.3 | 11.7 | 3.3 | 1.3 | 4.4 | 9.0 | 4.9 | 6.5 | **13.0** | **4.7** |
| Adjusted inflation excluding fuels (55.12%)** | %, y-o-y, end-of-period | 8.8 | 6.5 | 7.7 | 5.4 | 1.7 | 1.9 | 3.3 | 1.6 | 0.2 | 1.6 | 0.5 | 0.7 | 1.2 | **0.3** | **0.9** |
| Food prices (including alcoholic beverages and tobacco) (24.44%)** | %, y-o-y, end-of-period | 5.4 | 6.8 | 5.6 | -1.2 | -0.7 | 3.7 | 2.9 | -3.4 | 2.7 | 0.9 | -0.7 | 0.9 | 8.2 | **2.5** | **2.1** |
| Fuel prices (4.04%)** | %, y-o-y, end-of-period | -0.4 | 10.1 | 6.0 | -8.4 | 27.6 | 10.3 | -15.0 | 1.4 | -2.0 | 5.9 | 9.8 | -3.4 | 12.0 | **7.7** | **9.6** |
| GDP deflator | %, y-o-y | . | 10.3 | 8.4 | 11.1 | 2.8 | 1.5 | 4.9 | 2.8 | 0.9 | 4.5 | -0.2 | 1.7 | 3.1 | **2.1** | **2.3** |
| *Partial price indicators* | | | | | | | | | | | | | | | | |
| Producer prices | %,y-o-y, average | 7.5 | 4.7 | 4.8 | 4.9 | 1.0 | 5.1 | 3.0 | -0.5 | -0.3 | 5.6 | 3.1 | 1.4 | 4.1 | **2.8** | **2.3** |
| Agricultural prices | %,y-o-y, average | 8.9 | 7.5 | 2.7 | 3.2 | -11.3 | 8.6 | 9.6 | -7.5 | -4.5 | 9.6 | -9.8 | 1.3 | 15.9 | **5.6** | - |
| Construction work prices | %,y-o-y, average | 10.6 | 11.3 | 11.3 | 9.3 | 4.8 | 4.1 | 4.0 | 2.7 | 2.2 | 3.5 | 2.9 | 2.9 | 3.8 | - | - |
| Brent crude oil | %,y-o-y, average | - | 20.2 | -5.3 | -33.4 | 45.7 | 71.1 | -12.7 | 4.9 | 17.6 | 33.6 | 43.2 | 21.4 | 12.3 | **29.8** | **-3.3** |
| **LABOUR MARKET** | | | | | | | | | | | | | | | | |
| Average monthly wages in monitored organisations | %, y-o-y, nominal terms | 18.6 | 18.3 | 9.9 | 9.2 | 8.4 | 6.4 | 8.7 | 7.3 | 6.6 | 6.6 | 5.3 | 6.4 | **7.5** | **7.6** | **7.8** |
| Average monthly wages in monitored organisations | %, y-o-y real terms | 8.7 | 8.7 | 1.3 | -1.3 | 6.2 | 2.4 | 3.8 | 5.4 | 6.5 | 3.7 | 3.3 | 3.8 | **4.8** | **2.5** | **4.3** |
| Number of employees | %, y-o-y | -0.8 | -0.1 | -0.9 | -2.9 | -2.9 | -1.4 | 0.3 | -0.8 | -2.0 | -0.2 | 2.2 | 1.2 | **1.9** | **1.0** | **-0.3** |
| Nominal unit labour costs | %, y-o-y | - | 12.6 | 8.0 | 6.1 | 1.9 | 1.4 | 6.2 | 4.6 | 2.3 | 1.8 | 0.4 | 1.3 | **2.9** | **2.8** | **1.8** |
| Nominal unit labour costs in industry | %, y-o-y | - | - | - | - | - | - | - | - | -3.5 | -3.2 | -3.2 | -2.9 | - | - | - |
| Aggregate labour productivity | %, y-o-y | - | 4.0 | -0.7 | -0.8 | 1.3 | 3.6 | 2.5 | 1.9 | 3.6 | 4.1 | 5.3 | 4.4 | **4.4** | **4.4** | **5.7** |
| ILO general unemployment rate | %, average | - | - | - | - | - | - | - | - | 7.8 | 8.3 | 7.9 | 7.1 | 5.3 | **4.6** | **4.7** |
| Registered unemployment rate | %, average | - | - | - | - | - | - | - | - | - | 10.0 | 9.5 | 8.6 | 7.0 | **6.4** | **6.5** |
| **PUBLIC FINANCE** | | | | | | | | | | | | | | | | |
| Public finance deficit (ESA95) | CZK bn, current p. | -196.3 | -51.2 | -43.5 | -98.5 | -74.4 | -78.5 | -137.0 | -166.8 | -170.0 | -80.9 | -104.2 | -94.5 | **-83.4** | **-56.8** | **-92.3** |
| Public finance deficit / GDP* | %, nominal terms | -13.4 | -3.0 | -2.4 | -4.9 | -3.6 | -3.6 | -5.8 | -6.8 | -6.6 | -2.9 | -3.5 | -2.9 | **-2.3** | **-1.5** | **-2.2** |
| Public debt (ESA95) | CZK bn, current p. | 218.9 | 217.6 | 225.9 | 294.4 | 325.7 | 392.2 | 608.7 | 702.3 | 775.0 | 855.1 | 903.5 | 973.0 | **1 029.7** | **1 097.0** | **1 194.0** |
| Public debt / GDP* | %, nominal terms | 14.9 | 12.9 | 12.5 | 14.7 | 15.7 | 17.9 | 25.9 | 28.5 | 30.1 | 30.4 | 30.2 | 30.1 | **29.0** | **28.7** | **29.0** |
| **EXTERNAL RELATIONS** | | | | | | | | | | | | | | | | |
| *Current account* | | | | | | | | | | | | | | | | |
| Trade balance | CZK bn, current p. | -97.6 | -154.9 | -155.2 | -84.0 | -65.8 | -120.8 | -116.7 | -71.3 | -69.8 | -13.4 | 59.4 | 68.2 | **110.7** | **130.0** | **155.0** |
| Trade balance / GDP | % | -6.7 | -9.2 | -8.6 | -4.2 | -3.2 | -5.5 | -5.0 | -2.9 | -2.7 | -0.5 | 2.0 | 2.1 | **3.1** | **3.4** | **3.8** |
| Balance of services | CZK bn, current p. | 48.9 | 52.2 | 55.9 | 61.9 | 41.5 | 54.6 | 58.0 | 21.9 | 13.2 | 16.6 | 36.5 | 34.6 | **45.7** | **50.0** | **55.0** |
| Current account | CZK bn, current p. | -36.3 | -111.9 | -113.0 | -40.5 | -50.6 | -104.9 | -124.5 | -136.4 | -160.6 | -147.5 | -48.5 | -100.3 | **-115.9** | **-115.0** | **-110.0** |
| Current account / GDP | % | -2.5 | -6.6 | -6.2 | -2.0 | -2.4 | -4.8 | -5.3 | -5.5 | -6.2 | -5.2 | -1.6 | -3.1 | **-3.3** | **-3.0** | **-2.7** |
| *Foreign direct investment* | | | | | | | | | | | | | | | | |
| Direct investment | CZK bn, current p. | 67.0 | 34.6 | 40.5 | 115.9 | 215.7 | 190.8 | 208.3 | 270.9 | 53.5 | 101.8 | 279.6 | 104.3 | **145.0** | **160.0** | **140.0** |
| *Exchange rates* | | | | | | | | | | | | | | | | |
| CZK/USD | average | 26.5 | 27.1 | 31.7 | 32.3 | 34.6 | 38.7 | 38.0 | 32.7 | 28.2 | 25.7 | 24.0 | 22.6 | 20.3 | - | - |
| CZK/EUR | average | - | - | - | - | 36.9 | 35.6 | 34.1 | 30.8 | 31.8 | 31.9 | 29.8 | 28.3 | 27.8 | - | - |
| CZK/EUR | %, y-o-y, real (CPI euro area), average | - | - | - | - | - | - | - | - | - | -0.7 | -6.4 | -5.7 | -2.5 | - | - |
| CZK/EUR | %, y-o-y, real (CPI euro area), average | - | - | - | - | - | - | - | - | - | -3.2 | -5.4 | -1.3 | -3.7 | - | - |
| *Foreign trade prices* | | | | | | | | | | | | | | | | |
| Prices of exports of goods | %, y-o-y, average | 7.4 | 1.0 | 5.2 | 4.2 | -0.9 | 6.3 | 0.4 | -6.6 | 0.8 | 3.6 | -1.5 | -1.2 | **1.4** | **-2.2** | **1.8** |
| Prices of imports of goods | %, y-o-y, average | 5.6 | 1.4 | 5.1 | -2.7 | 1.9 | 11.9 | -1.5 | -8.5 | -0.3 | 1.6 | -0.5 | 0.3 | **-1.0** | **-1.4** | **0.9** |
| **MONEY AND INTEREST RATES** | | | | | | | | | | | | | | | | |
| M2 | %, y-o-y, average | 19.9 | 16.6 | 6.8 | 6.1 | 9.0 | 6.4 | 11.1 | 7.0 | 4.1 | 7.7 | 5.3 | 8.9 | **10.9** | **9.3** | **7.2** |
| 2W repo rate | %, end-of-period | 11.30 | 12.40 | 14.75 | 9.50 | 5.25 | 5.25 | 4.75 | 2.75 | 2.00 | 2.50 | 2.00 | 2.50 | 3.50 | - | - |
| 1Y PRIBOR | %, average | 11.0 | 11.8 | 14.6 | 14.1 | 7.0 | 5.8 | 5.3 | 3.6 | 2.3 | 2.7 | 2.1 | 2.7 | 3.4 | **3.8** | **3.2** |
| **MEMORANDUM ITEMS** | | | | | | | | | | | | | | | | |
| RMC gap | %, of actual value | - | -0.6 | -1.1 | -2.8 | -2.8 | -1.4 | -0.7 | -1.3 | -1.8 | -1.4 | -0.6 | 0.1 | 0.8 | **-0.4** | **-0.5** |
| Real GDP gap | %, of actual value | - | -0.1 | -1.7 | -3.1 | -3.8 | -2.1 | -1.2 | -2.2 | -3.1 | -2.3 | -0.6 | 0.7 | 1.2 | **0.0** | **-1.0** |
| Real wage gap | %, of actual value | - | -0.5 | 0.3 | -0.4 | 0.2 | 0.3 | 0.3 | 0.5 | 0.6 | 0.4 | -0.1 | -0.5 | -0.2 | **-0.4** | **0.3** |
| Equilibrium exchange rate | %, y-o-y, real terms | - | -3.6 | -1.3 | -4.1 | -5.1 | -4.5 | -4.9 | -4.5 | -3.0 | -2.9 | -3.6 | -3.8 | -3.8 | **-5.0** | **-3.7** |
| Equilibrium interest rate | %, pa, real terms | - | 2.1 | 2.1 | 2.3 | 2.3 | 2.3 | 2.0 | 1.6 | 1.3 | 1.2 | 1.2 | 1.4 | 1.7 | **2.0** | **2.0** |

* CNB calculation
** brackets are constant weights in actual consumer basket

data in bold = CNB forecast
\- data are not available / forecasted / released

| 2004 | | | | 2005 | | | | 2006 | | | | 2007 | | | | 2008 | | | | 2009 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| | | | | | | | | | | | | | | | | | | | | | | | |
| | | | | | | | | | | | | | | | | | | | | | | | |
| 580.5 | 629.4 | 627.2 | 636.9 | 614.3 | 669.6 | 666.5 | 681.2 | 654.7 | 712.4 | 708.7 | 723.2 | 686.4 | 749.8 | 743.0 | **764.2** | **731.2** | **790.2** | **780.1** | **790.7** | **760.4** | **824.3** | **817.6** | **832.5** |
| 3.9 | 4.3 | 4.4 | 5.3 | 5.8 | 6.4 | 6.3 | 7.0 | 6.6 | 6.4 | 6.3 | 6.2 | 4.9 | 4.8 | 5.2 | **5.7** | **4.9** | **4.4** | **3.8** | **3.5** | **4.0** | **4.3** | **4.8** | **5.3** |
| 3.2 | 2.7 | 2.4 | 3.2 | 1.3 | 2.6 | 2.2 | 2.9 | 4.9 | 5.3 | 5.0 | 6.2 | 4.2 | 4.1 | 3.8 | **4.1** | **3.0** | **2.8** | **2.7** | **2.6** | **3.2** | **3.6** | **4.7** | **5.3** |
| -3.8 | -0.7 | -4.0 | -5.5 | -0.2 | 1.7 | 5.8 | 1.8 | 2.6 | -1.5 | -2.2 | 1.4 | -0.3 | -1.0 | -1.5 | **0.9** | **-1.5** | **-2.4** | **-0.4** | **0.4** | **1.0** | **1.4** | **0.9** | **-0.3** |
| 5.1 | 4.1 | 3.2 | 3.5 | 0.5 | 1.9 | 2.9 | 3.6 | 5.9 | 5.7 | 5.2 | 5.2 | 4.0 | 6.7 | 7.5 | **6.5** | **7.7** | **8.0** | **7.5** | **7.9** | **8.7** | **8.7** | **9.1** | **9.3** |
| 9.9 | 28.1 | 22.4 | 22.1 | 16.5 | 7.2 | 11.6 | 12.9 | 19.3 | 11.4 | 11.3 | 16.0 | 8.9 | 9.9 | 9.8 | **12.3** | **9.8** | **10.2** | **9.5** | **9.2** | **10.5** | **10.8** | **10.9** | **11.1** |
| 10.0 | 27.0 | 18.6 | 15.9 | 8.6 | -0.5 | 6.1 | 6.5 | 17.8 | 11.1 | 10.7 | 16.1 | 9.1 | 8.2 | 7.9 | **11.0** | **11.1** | **10.7** | **9.3** | **9.6** | **10.6** | **11.0** | **11.3** | **10.8** |
| -27.1 | -42.4 | -36.4 | -47.8 | 5.4 | -0.9 | -10.4 | -16.0 | 14.0 | 0.8 | -7.7 | -18.8 | 6.1 | 10.5 | 4.1 | **-11.5** | **9.6** | **-2.3** | **-3.7** | **-15.5** | **9.6** | **-4.2** | **-7.2** | **-14.6** |
| | | | | | | | | | | | | | | | | | | | | | | | |
| 9.1 | 12.2 | 7.6 | 9.3 | 3.9 | 6.6 | 7.5 | 8.5 | 15.5 | 9.3 | 9.7 | 10.4 | 11.6 | 9.1 | 5.9 | - | - | - | - | - | - | - | - | - |
| 16.1 | 16.5 | 4.5 | 5.0 | -3.2 | 0.1 | 7.3 | 9.7 | 0.5 | 6.2 | 7.4 | 9.5 | 28.9 | 3.5 | -0.1 | - | - | - | - | - | - | - | - | - |
| 1.0 | 2.7 | 1.9 | 4.1 | 4.2 | 4.9 | 4.0 | 2.9 | 6.9 | 6.2 | 6.2 | 6.6 | 9.8 | 7.9 | 6.7 | - | - | - | - | - | - | - | - | - |
| | | | | | | | | | | | | | | | | | | | | | | | |
| | | | | | | | | | | | | | | | | | | | | | | | |
| 0.8 | 1.4 | 2.2 | 2.8 | 2.6 | 2.4 | 2.0 | 1.9 | 2.2 | 2.5 | 2.8 | 2.5 | 2.2 | 2.1 | 2.0 | 2.5 | **3.7** | **4.9** | **5.9** | **6.3** | **5.8** | **4.7** | **3.7** | **2.8** |
| 2.5 | 2.9 | 3.0 | 2.8 | 1.5 | 1.8 | 2.2 | 2.2 | 2.8 | 2.8 | 2.7 | 1.7 | 1.6 | 2.5 | 2.5 | 4.8 | **6.8** | **6.8** | **6.4** | **5.3** | **3.4** | **2.4** | **2.3** | **2.3** |
| 1.7 | 1.9 | 2.3 | 2.2 | 1.5 | 1.5 | 1.9 | 2.4 | 2.5 | 2.5 | 2.6 | 1.3 | 1.4 | 2.0 | 1.6 | 3.7 | **4.6** | **4.5** | **4.5** | **3.5** | **2.9** | **2.4** | **2.3** | **2.3** |
| 4.7 | 2.4 | 2.3 | 4.4 | 2.9 | 5.8 | 6.8 | 9.0 | 11.2 | 10.5 | 9.8 | 4.9 | 4.1 | 4.2 | 4.5 | 6.4 | **13.1** | **13.7** | **13.8** | **13.1** | **6.2** | **5.1** | **4.8** | **4.7** |
| | | | | | | | | | | | | | | | | | | | | | | | |
| 0.8 | 1.1 | 1.5 | 1.6 | 1.0 | 0.9 | 0.6 | 0.5 | 0.6 | 0.4 | 0.6 | 0.7 | 0.4 | 0.9 | 0.4 | 1.0 | **1.2** | **1.1** | **0.8** | **0.4** | **0.3** | **0.3** | **0.5** | **0.8** |
| | | | | | | | | | | | | | | | | | | | | | | | |
| 1.4 | 2.7 | 3.0 | 0.9 | 0.4 | -0.4 | -0.2 | -0.7 | -1.8 | -0.6 | 1.4 | 0.9 | 2.6 | 3.4 | 2.5 | 6.8 | **5.5** | **5.8** | **6.2** | **3.5** | **4.6** | **3.6** | **2.9** | **2.5** |
| -5.4 | 11.2 | 7.4 | 5.9 | 1.4 | 2.7 | 21.6 | 9.8 | 10.9 | 8.3 | -7.5 | -3.4 | -4.4 | -2.7 | -2.6 | 8.5 | **16.1** | **8.6** | **8.6** | **9.3** | **9.3** | **9.2** | **9.0** | **8.9** |
| 4.6 | 3.9 | 4.8 | 4.8 | 1.2 | -0.1 | -0.4 | -1.3 | 0.4 | 1.2 | 2.5 | 2.5 | 3.4 | 3.6 | 3.3 | **2.2** | **1.0** | **2.0** | **2.2** | **3.3** | **2.7** | **2.3** | **2.2** | **1.9** |
| | | | | | | | | | | | | | | | | | | | | | | | |
| 1.7 | 4.9 | 7.7 | 8.1 | 6.9 | 4.2 | 1.5 | 0.0 | 0.1 | 1.1 | 2.4 | 2.0 | 3.2 | 4.2 | 3.9 | 5.0 | **4.7** | **2.9** | **2.1** | **1.4** | **2.0** | **2.2** | **2.4** | **2.5** |
| 13.8 | 15.0 | 6.8 | 2.8 | -10.6 | -14.1 | -8.8 | -5.8 | -1.5 | 4.6 | 2.7 | 2.6 | 13.3 | 10.7 | 14.2 | 25.2 | **20.2** | **15.4** | **1.1** | **-14.4** | - | - | - | - |
| 2.2 | 2.9 | 4.6 | 4.3 | 4.1 | 2.4 | 2.3 | 2.6 | 2.4 | 2.7 | 3.2 | 3.3 | 3.4 | 3.6 | 3.9 | 4.4 | - | - | - | - | - | - | - | - |
| 1.9 | 36.0 | 46.5 | 50.2 | 48.9 | 46.0 | 48.1 | 29.9 | 30.8 | 35.6 | 14.3 | 5.0 | -6.1 | -1.5 | 7.8 | 49.0 | **61.3** | **34.1** | **21.9** | **2.0** | **-3.9** | **-3.3** | **-3.2** | **-2.9** |
| | | | | | | | | | | | | | | | | | | | | | | | |
| 8.9 | 4.2 | 7.3 | 6.3 | 5.7 | 5.4 | 6.2 | 3.9 | 7.0 | 6.6 | 5.9 | 6.1 | 7.9 | 7.5 | 7.6 | **7.2** | **7.8** | **7.3** | **7.9** | **7.5** | **7.4** | **8.1** | **8.1** | **7.6** |
| | | | | | | | | | | | | | | | | | | | | | | | |
| 6.4 | 1.7 | 4.1 | 3.1 | 4.0 | 3.8 | 4.2 | 1.5 | 4.0 | 3.5 | 2.9 | 4.5 | 6.2 | 4.9 | 5.0 | **3.2** | **2.6** | **2.4** | **2.8** | **2.4** | **3.5** | **4.6** | **4.8** | **4.4** |
| -1.6 | -0.4 | 0.1 | 1.1 | 1.7 | 1.9 | 2.9 | 2.3 | 2.2 | 1.6 | 0.3 | 0.7 | 1.3 | 1.8 | 2.1 | **2.4** | **1.5** | **1.2** | **1.0** | **0.2** | **-0.2** | **-0.3** | **-0.4** | **-0.3** |
| 3.4 | 0.2 | 2.5 | 1.0 | 0.5 | 1.1 | 1.2 | -1.2 | 1.1 | 1.1 | 1.1 | 2.0 | 3.1 | 2.6 | 3.1 | **2.7** | **3.0** | **2.5** | **2.9** | **3.0** | **2.1** | **1.9** | **1.7** | **1.3** |
| -1.6 | -6.4 | -0.8 | -3.4 | -1.8 | -2.8 | -3.8 | -4.6 | -7.2 | -1.4 | -1.8 | -3.5 | -1.3 | 0.6 | 2.5 | - | - | - | - | - | - | - | - | - |
| 3.9 | 4.3 | 3.6 | 4.7 | 5.1 | 5.2 | 5.3 | 5.8 | 5.0 | 4.7 | 4.2 | 3.8 | 4.3 | 4.6 | 4.5 | **4.3** | **4.3** | **4.5** | **4.6** | **4.2** | **5.0** | **5.8** | **6.0** | **6.1** |
| 8.7 | 8.2 | 8.2 | 8.2 | 8.4 | 7.8 | 7.8 | 7.8 | 8.0 | 7.1 | 7.0 | 6.5 | 6.0 | 5.3 | 5.1 | **4.8** | **4.9** | **4.4** | **4.6** | **4.6** | **4.8** | **4.6** | **4.8** | **4.8** |
| 10.5 | 9.8 | 9.9 | 9.8 | 10.3 | 9.3 | 9.3 | 9.2 | 9.6 | 8.5 | 8.3 | 8.0 | 8.2 | 7.0 | 6.7 | 6.3 | **6.8** | **6.1** | **6.3** | **6.5** | **6.8** | **6.2** | **6.4** | **6.5** |
| | | | | | | | | | | | | | | | | | | | | | | | |
| - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| | | | | | | | | | | | | | | | | | | | | | | | |
| | | | | | | | | | | | | | | | | | | | | | | | |
| 1.3 | -5.7 | -3.2 | -5.8 | 28.4 | 18.8 | 5.0 | 7.2 | 31.0 | 14.3 | 10.0 | 12.9 | 46.4 | 25.3 | 19.0 | **20.0** | **45.0** | **32.0** | **25.0** | **28.0** | **50.0** | **37.0** | **32.0** | **36.0** |
| 0.2 | -0.8 | -0.5 | -0.8 | 4.1 | 2.5 | 0.7 | 0.9 | 4.2 | 1.7 | 1.2 | 1.5 | 5.7 | 2.8 | 2.1 | **2.2** | **5.1** | **3.3** | **2.6** | **2.8** | **5.3** | **3.5** | **3.1** | **3.4** |
| 4.9 | 5.7 | 4.5 | 1.5 | 9.3 | 12.2 | 10.0 | 5.1 | 7.2 | 11.2 | 10.9 | 5.2 | 9.3 | 15.2 | 13.2 | **8.0** | **11.0** | **15.0** | **15.0** | **9.0** | **12.0** | **17.0** | **16.0** | **10.0** |
| -13.1 | -41.3 | -58.7 | -34.4 | 24.4 | -27.0 | -28.0 | -17.9 | 17.6 | -32.5 | -39.6 | -45.8 | 16.5 | -42.7 | -47.8 | **-42.0** | **11.0** | **-47.0** | **-37.0** | **-42.0** | **13.0** | **-49.0** | **-35.0** | **-39.0** |
| -2.0 | -5.8 | -8.2 | -4.7 | 3.5 | -3.6 | -3.7 | -2.3 | 2.4 | -4.0 | -4.8 | -5.4 | 2.0 | -4.7 | -5.3 | **-4.6** | **1.3** | **-4.8** | **-3.8** | **-4.2** | **1.4** | **-4.7** | **-3.4** | **-3.6** |
| | | | | | | | | | | | | | | | | | | | | | | | |
| 27.2 | 26.8 | 30.4 | 17.3 | 27.5 | 138.6 | 59.5 | 54.0 | 13.0 | 21.5 | 40.3 | 29.5 | 35.6 | 28.9 | 37.5 | - | - | - | - | - | - | - | - | - |
| | | | | | | | | | | | | | | | | | | | | | | | |
| 26.3 | 26.6 | 25.9 | 24.1 | 22.9 | 23.9 | 24.3 | 24.7 | 23.8 | 22.6 | 22.2 | 21.7 | 21.4 | 21.0 | 20.3 | 18.5 | - | - | - | - | - | - | - | - |
| 32.9 | 32.0 | 31.6 | 31.1 | 30.0 | 30.1 | 29.7 | 29.4 | 28.6 | 28.4 | 28.3 | 28.0 | 28.0 | 28.3 | 27.9 | 26.8 | - | - | - | - | - | - | - | - |
| 2.9 | 1.1 | -3.0 | -3.9 | -8.3 | -5.7 | -5.7 | -5.7 | -5.5 | -6.6 | -5.7 | -4.8 | -1.4 | -0.7 | -1.7 | -6.0 | - | - | - | - | - | - | - | - |
| 2.3 | -1.3 | -6.4 | -7.2 | -11.0 | -6.0 | -3.2 | -1.2 | 0.3 | -1.3 | -1.7 | -2.7 | -2.2 | -2.4 | -3.6 | -6.5 | - | - | - | - | - | - | - | - |
| | | | | | | | | | | | | | | | | | | | | | | | |
| 2.6 | 4.2 | 3.9 | 3.9 | 0.0 | -0.7 | -2.3 | -2.8 | -1.9 | -2.3 | -0.5 | 0.0 | 1.9 | 2.7 | 1.9 | **-1.1** | **-2.6** | **-3.8** | **-2.9** | **0.5** | **1.8** | **2.5** | **1.6** | **1.2** |
| 0.1 | 2.2 | 2.3 | 1.9 | -1.3 | -0.4 | -0.6 | 0.3 | 1.6 | 0.6 | 0.2 | -1.4 | -1.7 | -0.4 | -0.5 | **-1.5** | **-0.4** | **-2.5** | **-2.8** | **0.0** | **0.3** | **0.9** | **1.2** | **1.1** |
| | | | | | | | | | | | | | | | | | | | | | | | |
| 7.1 | 9.3 | 8.0 | 6.3 | 4.8 | 5.1 | 4.5 | 6.6 | 8.8 | 8.3 | 9.0 | 9.6 | 10.5 | 11.6 | 11.2 | **10.1** | **9.8** | **10.1** | **8.6** | **8.8** | **8.5** | **7.4** | **6.5** | **6.4** |
| 2.00 | 2.25 | 2.50 | 2.50 | 2.25 | 1.75 | 1.75 | 2.00 | 2.00 | 2.00 | 2.50 | 2.50 | 2.50 | 2.75 | 3.25 | 3.50 | - | - | - | - | - | - | - | - |
| 2.3 | 2.5 | 3.0 | 2.9 | 2.4 | 1.9 | 1.9 | 2.4 | 2.3 | 2.5 | 2.8 | 3.0 | 2.8 | 3.2 | 3.7 | 4.0 | **4.3** | **3.9** | **3.6** | **3.4** | **3.1** | **3.1** | **3.2** | **3.2** |
| | | | | | | | | | | | | | | | | | | | | | | | |
| -1.8 | -1.5 | -1.3 | -1.1 | -0.8 | -0.6 | -0.5 | -0.3 | -0.3 | -0.1 | 0.2 | 0.4 | 0.6 | 0.8 | 0.8 | 0.8 | **0.4** | **-0.3** | **-0.7** | **-1.0** | **-0.7** | **-0.5** | **-0.4** | **-0.4** |
| -2.8 | -2.5 | -2.1 | -1.8 | -1.4 | -0.9 | -0.4 | 0.1 | 0.3 | 0.6 | 0.9 | 0.9 | 1.0 | 1.2 | 1.3 | 1.3 | **0.7** | **0.3** | **-0.3** | **-0.8** | **-0.9** | **-1.0** | **-1.1** | **-1.1** |
| 0.5 | 0.5 | 0.4 | 0.4 | 0.2 | 0.1 | -0.2 | -0.4 | -0.5 | -0.6 | -0.5 | -0.3 | -0.2 | -0.2 | -0.2 | -0.3 | **-0.2** | **-0.5** | **-0.5** | **-0.3** | **0.0** | **0.3** | **0.4** | **0.4** |
| -2.7 | -2.8 | -3.0 | -3.2 | -3.4 | -3.6 | -3.7 | -3.8 | -3.8 | -3.9 | -3.8 | -3.8 | -3.7 | -3.7 | -3.7 | -3.8 | **-5.0** | **-5.1** | **-5.1** | **-5.0** | **-3.8** | **-3.7** | **-3.6** | **-3.6** |
| 1.2 | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 | 1.3 | 1.3 | 1.4 | 1.5 | 1.6 | 1.7 | 1.8 | 1.9 | **1.9** | **2.0** | **2.0** | **2.0** | **2.0** | **2.0** | **2.0** | **2.0** |

**Table 2a**

**INFLATION DEVELOPMENT**

annual percentage changes

| 2004 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Consumer prices | 2.3 | 2.3 | 2.5 | 2.3 | 2.7 | 2.9 | 3.2 | 3.4 | 3.0 | 3.5 | 2.9 | 2.8 |
| Regulated prices | 5.0 | 4.9 | 4.7 | 3.1 | 2.4 | 2.4 | 2.4 | 2.3 | 2.3 | 4.4 | 4.4 | 4.4 |
| (contribution to consumer price inflation) | *1.01* | *0.99* | *0.96* | *0.64* | *0.50* | *0.50* | *0.50* | *0.47* | *0.47* | *0.91* | *0.90* | *0.90* |
| First-round impacts of changes to indirect taxes on 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* |
| 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* |
| Monetary-policy relevant inflation | 1.6 | 1.6 | 1.8 | 1.6 | 2.0 | 2.0 | 2.4 | 2.5 | 2.1 | 2.6 | 2.0 | 1.9 |
| 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* |
| 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* |
| Monetary-policy relevant inflation | 1.5 | 1.5 | 1.4 | 1.5 | 1.2 | 1.7 | 1.7 | 1.8 | 2.3 | 2.7 | 2.5 | 2.2 |
| 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* |
| 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* |
| Monetary-policy relevant inflation | 2.7 | 2.5 | 2.4 | 2.5 | 2.7 | 2.4 | 2.5 | 2.9 | 2.5 | 1.1 | 1.3 | 1.6 |
| 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** | | | | | | | | | | | | |
| Consumer prices | 1.3 | 1.5 | 1.9 | 2.5 | 2.4 | 2.5 | 2.3 | 2.4 | 2.8 | 4.0 | 5.0 | 5.4 |
| Regulated prices | 3.9 | 4.3 | 4.1 | 4.7 | 4.0 | 4.0 | 4.4 | 4.4 | 4.6 | 6.3 | 6.4 | 6.5 |
| (contribution to consumer price inflation) | *0.66* | *0.72* | *0.70* | *0.80* | *0.69* | *0.68* | *0.75* | *0.74* | *0.79* | *1.07* | *1.08* | *1.11* |
| 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* | *0.64* | *1.07* | *1.09* | *1.09* | *1.09* | *1.09* |
| Prices of food, beverages and tobacco | 2.0 | 2.7 | 3.2 | 4.1 | 3.5 | 2.7 | 2.6 | 2.3 | 2.5 | 4.6 | 7.5 | 8.2 |
| (contribution to consumer price inflation) | *0.48* | *0.67* | *0.78* | *1.01* | *0.85* | *0.67* | *0.64* | *0.56* | *0.63* | *1.17* | *1.90* | *2.09* |
| Adjusted inflation excluding fuels | 0.3 | 0.4 | 0.6 | 0.8 | 0.8 | 1.0 | 0.5 | 0.1 | 0.7 | 0.9 | 1.0 | 1.2 |
| (contribution to consumer price inflation) | *0.19* | *0.20* | *0.34* | *0.43* | *0.46* | *0.57* | *0.27* | *0.08* | *0.37* | *0.49* | *0.56* | *0.64* |
| Fuel prices | -3.5 | -6.6 | -3.1 | -3.6 | -2.9 | -1.7 | -2.5 | -3.5 | -1.8 | 3.8 | 9.7 | 12.0 |
| (contribution to consumer price inflation) | *-0.14* | *-0.26* | *-0.12* | *-0.15* | *-0.12* | *-0.07* | *-0.11* | *-0.15* | *-0.07* | *0.15* | *0.38* | *0.46* |
| Monetary-policy relevant inflation | 1.2 | 1.4 | 1.7 | 2.2 | 1.9 | 1.9 | 1.7 | 1.3 | 1.7 | 2.9 | 3.9 | 4.3 |
| Inflation rate (annual moving average) | 2.4 | 2.3 | 2.2 | 2.2 | 2.1 | 2.1 | 2.1 | 2.0 | 2.0 | 2.2 | 2.5 | 2.8 |
| **2008** | | **forecast** | | | | | | | | | | |
| Consumer prices | **6.7** | **6.9** | **6.9** | | | | | | | | | |
| Regulated prices | **13.1** | **13.1** | **13.1** | | | | | | | | | |
| (contribution to consumer price inflation) | ***2.26*** | ***2.27*** | ***2.26*** | | | | | | | | | |
| First-round impacts of changes to indirect taxes on consumer prices (contribution to consumer price inflation) | ***2.21*** | ***2.17*** | ***2.25*** | | | | | | | | | |
| Prices of food, beverages and tobacco | **5.3** | **5.4** | **5.7** | | | | | | | | | |
| (contribution to consumer price inflation) | ***1.31*** | ***1.34*** | ***1.39*** | | | | | | | | | |
| Adjusted inflation excluding fuels | **1.2** | **1.3** | **1.2** | | | | | | | | | |
| (contribution to consumer price inflation) | ***0.65*** | ***0.69*** | ***0.67*** | | | | | | | | | |
| Fuel prices | **14.9** | **18.3** | **15.0** | | | | | | | | | |
| (contribution to consumer price inflation) | ***0.56*** | ***0.67*** | ***0.56*** | | | | | | | | | |
| Monetary-policy relevant inflation | **4.5** | **4.7** | **4.6** | | | | | | | | | |
| Inflation rate (annual moving average) | **3.3** | **3.7** | **4.2** | | | | | | | | | |

CNB calculation based on CZSO data

**Table 2b**

**INFLATION DEVELOPMENT** monthly percentage changes

| 2004 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 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* |
| 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* |
| Monetary-policy relevant inflation | 1.2 | 0.2 | 0.1 | -0.1 | 0.4 | 0.1 | 0.3 | 0.0 | -0.8 | 0.5 | -0.1 | 0.1 |
| **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* |
| 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* |
| Monetary-policy relevant inflation | 0.7 | 0.2 | -0.1 | 0.1 | 0.2 | 0.6 | 0.3 | 0.0 | -0.3 | 0.9 | -0.3 | -0.2 |
| **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* |
| 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) | *-0.06* | *0.02* | *-0.01* | *0.14* | *0.11* | *0.00* | *0.05* | *0.02* | *-0.08* | *-0.17* | *-0.08* | *-0.03* |
| Monetary-policy relevant inflation | 1.2 | 0.0 | -0.2 | 0.1 | 0.5 | 0.3 | 0.4 | 0.3 | -0.7 | -0.5 | -0.1 | 0.2 |
| **2007** | | | | | | | | | | | | |
| Consumer prices | 1.0 | 0.3 | 0.3 | 0.7 | 0.4 | 0.3 | 0.4 | 0.3 | -0.3 | 0.6 | 0.9 | 0.5 |
| Regulated prices | 3.2 | 0.6 | 0.0 | 0.6 | 0.3 | 0.1 | 0.4 | 0.1 | 0.2 | 0.7 | 0.0 | 0.2 |
| (contribution to consumer price inflation) | *0.54* | *0.10* | *0.01* | *0.11* | *0.05* | *0.01* | *0.07* | *0.02* | *0.03* | *0.12* | *0.01* | *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* | *0.10* | *0.25* | *0.02* | *0.01* | *0.00* | *0.00* |
| Prices of food, beverages and tobacco | 1.2 | 0.2 | 0.1 | 1.0 | 0.0 | 0.1 | -0.3 | -0.1 | 0.1 | 1.5 | 2.9 | 1.2 |
| (contribution to consumer price inflation) | *0.30* | *0.04* | *0.02* | *0.24* | *0.01* | *0.03* | *-0.07* | *-0.03* | *0.03* | *0.39* | *0.73* | *0.31* |
| Adjusted inflation excluding fuels | 0.3 | 0.2 | 0.0 | 0.1 | 0.1 | 0.1 | 0.4 | 0.1 | -0.6 | 0.2 | 0.0 | 0.2 |
| (contribution to consumer price inflation) | *0.14* | *0.11* | *0.01* | *0.05* | *0.04* | *0.07* | *0.22* | *0.07* | *-0.34* | *0.10* | *0.02* | *0.13* |
| Fuel prices | -2.1 | -2.6 | 3.3 | 4.3 | 4.3 | 1.3 | 0.8 | -0.3 | -0.9 | -0.1 | 2.9 | 0.8 |
| (contribution to consumer price inflation) | *-0.08* | *-0.10* | *0.12* | *0.16* | *0.17* | *0.05* | *0.03* | *-0.01* | *-0.03* | *0.00* | *0.11* | *0.03* |
| Monetary-policy relevant inflation | 0.9 | 0.1 | 0.2 | 0.6 | 0.3 | 0.2 | 0.3 | 0.1 | -0.3 | 0.6 | 0.9 | 0.5 |
| **2008** | | **forecast** | | | | | | | | | | |
| Consumer prices | **2.3** | **0.4** | **0.3** | | | | | | | | | |
| Regulated prices | **9.5** | **0.6** | **0.0** | | | | | | | | | |
| (contribution to consumer price inflation) | ***1.62*** | ***0.11*** | ***0.00*** | | | | | | | | | |
| First-round impacts of changes to indirect taxes on consumer prices (contribution to consumer price inflation) | ***1.22*** | ***0.10*** | ***0.22*** | | | | | | | | | |
| Prices of food, beverages and tobacco | **-1.4** | **0.3** | **0.3** | | | | | | | | | |
| (contribution to consumer price inflation) | ***-0.36*** | ***0.06*** | ***0.07*** | | | | | | | | | |
| Adjusted inflation excluding fuels | **0.3** | **0.3** | **0.0** | | | | | | | | | |
| (contribution to consumer price inflation) | ***0.15*** | ***0.14*** | ***-0.01*** | | | | | | | | | |
| Fuel prices | **0.5** | **0.3** | **0.3** | | | | | | | | | |
| (contribution to consumer price inflation) | ***0.02*** | ***0.01*** | ***0.01*** | | | | | | | | | |
| Monetary-policy relevant inflation | **1.0** | **0.3** | **0.1** | | | | | | | | | |

CNB calculation based on CZSO data

**Table 3**

**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 | 5.8 | 6.1 | 5.8 | 6.4 | 7.4 | 7.9 | 5.4 |
| Food and non-alcoholic beverages | 162.6 | 3.1 | 3.2 | 3.3 | 5.0 | 4.8 | 5.0 | 4.5 | 4.1 | 4.2 | 6.6 | 10.9 | 12.9 | 5.6 |
| Alcoholic beverages and tobacco | 81.7 | 2.6 | 4.6 | 6.5 | 7.7 | 9.7 | 10.9 | 12.2 | 15.8 | 16.2 | 16.5 | 17.4 | 17.5 | 11.5 |
| Clothing and footwear | 52.4 | -7.3 | -7.3 | -6.8 | -5.7 | -5.5 | -5.6 | -7.6 | -8.3 | -7.5 | -6.5 | -6.2 | -5.9 | -6.7 |
| Housing, water, electricity, gas and other fuels | 248.3 | 8.2 | 8.5 | 8.6 | 9.0 | 9.3 | 9.5 | 9.9 | 10.2 | 10.6 | 11.3 | 11.5 | 11.7 | 9.9 |
| Furnishings, household equipment and routine maintenance of the house | 58.1 | -1.5 | -1.6 | -1.6 | -1.4 | -1.3 | -1.4 | -1.4 | -1.5 | -1.5 | -1.5 | -1.4 | -1.3 | -1.4 |
| Health | 17.9 | 6.6 | 6.7 | 6.7 | 9.7 | 10.1 | 9.9 | 9.3 | 9.2 | 9.0 | 8.7 | 8.7 | 8.9 | 8.6 |
| Transport | 114.1 | -0.8 | -1.6 | -0.4 | 0.9 | 2.3 | 2.9 | 3.2 | 3.2 | 2.7 | 2.8 | 3.9 | 4.5 | 2.0 |
| Communications | 38.7 | 8.1 | 8.0 | 7.9 | 7.7 | 7.6 | 7.5 | 7.5 | 6.3 | 5.4 | 5.3 | 5.1 | 4.9 | 6.8 |
| Recreation and culture | 98.6 | 1.5 | 2.3 | 1.4 | 0.9 | 0.8 | 1.1 | 4.2 | 5.2 | 0.7 | 0.4 | -0.5 | -0.2 | 1.5 |
| Education | 6.2 | 5.2 | 5.3 | 5.3 | 5.3 | 5.3 | 5.3 | 5.3 | 5.3 | 7.2 | 7.3 | 7.3 | 7.3 | 6.0 |
| Hotels, cafés and restaurants | 58.4 | 4.0 | 4.2 | 4.4 | 4.7 | 5.0 | 5.3 | 5.6 | 5.7 | 6.1 | 6.3 | 7.0 | 7.8 | 5.5 |
| Miscellaneous goods and services | 63.0 | 2.9 | 3.6 | 4.0 | 4.1 | 4.1 | 4.0 | 4.1 | 4.0 | 4.0 | 4.1 | 4.3 | 4.2 | 4.0 |

Source: CZSO

**Table 4**

**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 | -2.5 | -3.5 | -1.8 | 3.8 | 9.7 | 12.0 |
| Other tradables excluding food and fuel prices | -2.4 | -2.6 | -2.0 | -1.6 | -1.7 | -1.6 | -2.2 | -2.3 | -1.5 | -1.2 | -1.1 | -1.0 |
| Prices of tradables excluding regulated prices | 2.5 | 2.8 | 2.9 | 3.2 | 2.6 | 2.8 | 2.4 | 1.9 | 2.3 | 2.4 | 2.5 | 2.6 |
| Prices of non-food commodities excluding regulated prices | 0.1 | -0.1 | 0.4 | 0.6 | 0.7 | 1.0 | 0.4 | 0.0 | 0.6 | 1.1 | 1.6 | 1.9 |
| Prices of tradables - food | 2.4 | 3.2 | 4.1 | 5.5 | 5.3 | 5.0 | 5.3 | 6.7 | 7.1 | 9.3 | 12.3 | 13.0 |
| Prices of nontradables - regulated prices | 3.9 | 4.3 | 4.1 | 4.7 | 4.0 | 4.0 | 4.4 | 4.4 | 4.6 | 6.3 | 6.4 | 6.5 |

CNB calculation based on CZSO data

**Table 5**

**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 |
| 7/07 | 3.1 | — |
| 8/07 | 3.6 | — |
| 9/07 | 4.2 | 3.6 |
| 10/07 | 4.3 | — |
| 11/07 | 4.3 | — |
| 12/07 | 4.5 | 4.9 |

Source: CNB statistical survey

**Table 6**

**HARMONISED INDEX OF CONSUMER PRICES**

annual percentage changes

| | 2003<br>12 | 2004<br>12 | 2005<br>12 | 2006<br>12 | 2007<br>12 |
|---|---|---|---|---|---|
| European Union (27 countries) | 2.1 | 2.5 | 2.3 | 2.2 | 3.2 |
| European Union (25 countries) | 1.9 | 2.4 | 2.1 | 2.2 | 3.1 |
| Belgium | 1.7 | 1.9 | 2.8 | 2.1 | 3.1 |
| Bulgaria | 5.6 | 4.0 | 7.4 | 6.1 | 11.6 |
| Czech Republic | 0.9 | 2.5 | 1.9 | 1.5 | 5.5 |
| Denmark | 1.2 | 0.9 | 2.2 | 1.7 | 2.4 |
| Germany | 1.0 | 2.3 | 2.1 | 1.4 | 3.1 |
| Estonia | 1.2 | 4.8 | 3.6 | 5.1 | 9.7 |
| Ireland | 3.0 | 2.4 | 1.9 | 3.0 | |
| Greece | 3.1 | 3.1 | 3.5 | 3.2 | 3.9 |
| Spain | 2.7 | 3.3 | 3.7 | 2.7 | 4.3 |
| France | 2.4 | 2.3 | 1.8 | 1.7 | 2.8 |
| Italy | 2.5 | 2.4 | 2.1 | 2.1 | 2.8 |
| Cyprus | 2.2 | 3.9 | 1.4 | 1.5 | 3.7 |
| Latvia | 3.5 | 7.4 | 7.1 | 6.8 | 14.0 |
| Lithuania | -1.3 | 2.8 | 3.0 | 4.5 | 8.2 |
| Luxembourg | 2.4 | 3.5 | 3.4 | 2.3 | 4.3 |
| Hungary | 5.6 | 5.5 | 3.3 | 6.6 | 7.4 |
| Malta | 2.4 | 1.9 | 3.4 | 0.8 | 3.1 |
| Netherlands | 1.6 | 1.2 | 2.0 | 1.7 | 1.6 |
| Austria | 1.3 | 2.5 | 1.6 | 1.6 | 3.5 |
| Poland | 1.6 | 4.4 | 0.8 | 1.4 | 4.2 |
| Portugal | 2.3 | 2.6 | 2.5 | 2.5 | 2.7 |
| Romania | 14.1 | 9.3 | 8.7 | 4.9 | 6.7 |
| Slovenia | 4.7 | 3.3 | 2.4 | 3.0 | 5.7 |
| Slovakia | 9.4 | 5.8 | 3.9 | 3.7 | 2.5 |
| Finland | 1.2 | 0.1 | 1.1 | 1.2 | 1.9 |
| Sweden | 1.8 | 0.9 | 1.3 | 1.4 | 2.5 |
| United Kingdom | 1.3 | 1.7 | 1.9 | 3.0 | 2.1 |

Source: Eurostat

**Table 7**

| MONETARY SURVEY | | | | | position at month-end in CZK billions |
|---|---|---|---|---|---|
| | 2003 12 | 2004 12 | 2005 12 | 2006 12 | 2007 11 |
| **Total assets** | 1,766.1 | 1,844.1 | 1,992.1 | 2,188.7 | 2,383.9 |
| Net external assets (NEAs) | 821.5 | 863.3 | 1,076.4 | 972.6 | 945.5 |
| NEAs of CNB | 687.5 | 634.1 | 724.7 | 659.1 | 616.4 |
| NEAs of OMFIs | 134.0 | 229.3 | 351.7 | 313.5 | 329.0 |
| Net domestic assets | 944.5 | 980.8 | 915.8 | 1,216.0 | 1,438.4 |
| Domestic loans | 1,145.6 | 1,147.0 | 1,166.6 | 1,422.4 | 1,656.7 |
| Net credit to government (NCG) (including securities) | 354.0 | 257.5 | 99.1 | 136.3 | 63.3 |
| NCG to central government (including securities) | 408.7 | 312.4 | 163.0 | 206.9 | 182.6 |
| NCG to other government (including securities) | -54.8 | -54.9 | -64.0 | -70.6 | -119.3 |
| Loans to corporations and households (excluding securities) | 791.6 | 889.4 | 1,067.5 | 1,286.1 | 1,593.4 |
| Loans to corporations (excluding securities) | 554.1 | 574.2 | 649.7 | 745.5 | 895.1 |
| Loans to households (excluding securities) | 237.5 | 315.2 | 417.8 | 540.6 | 698.4 |
| Other net items (including securities and capital) | -201.1 | -166.2 | -250.8 | -206.4 | -218.3 |
| Holdings of securities | 16.6 | 18.8 | 14.4 | 14.0 | 16.1 |
| Issued securities | -51.6 | -74.9 | -119.1 | -121.8 | -153.7 |
| **Liabilities** | | | | | |
| Monetary aggregate M2 | 1,766.1 | 1,844.1 | 1,992.1 | 2,188.7 | 2,383.9 |
| Monetary aggregate M1 | 902.8 | 962.3 | 1,087.3 | 1,239.8 | 1,383.2 |
| Currency in circulation | 221.4 | 236.8 | 263.8 | 295.3 | 323.3 |
| Overnight deposits | 681.4 | 725.6 | 823.5 | 944.5 | 1,059.9 |
| Overnight deposits - households | 372.1 | 410.8 | 456.6 | 529.3 | 613.7 |
| Overnight deposits - corporations | 309.3 | 314.7 | 367.0 | 415.3 | 446.3 |
| M2-M1 (quasi money) | 863.3 | 881.8 | 904.8 | 948.9 | 1,000.7 |
| Deposits with agreed maturity | 666.4 | 675.3 | 671.4 | 674.9 | 693.9 |
| Deposits with agreed maturity - households | 439.8 | 458.6 | 445.1 | 433.6 | 428.5 |
| Deposits with agreed maturity - corporations | 226.6 | 216.7 | 226.3 | 241.3 | 265.3 |
| Deposits redeemable at notice | 185.6 | 198.8 | 224.1 | 265.6 | 295.0 |
| Deposits redeemable at notice - households | 182.3 | 194.6 | 220.6 | 260.8 | 290.8 |
| Deposits redeemable at notice - corporations | 3.2 | 4.2 | 3.6 | 4.8 | 4.2 |
| Repurchase agreements | 11.3 | 7.6 | 9.3 | 8.4 | 11.8 |
| | | | | | |
| Annual percentage changes | | | | | |
| M1 | 14.6 | 6.6 | 13.0 | 14.0 | 11.4 |
| M2 | 6.9 | 4.4 | 8.0 | 9.9 | 11.3 |
| Loans to corporations and households | 9.3 | 12.4 | 20.0 | 20.5 | 24.3 |
| M2-M1 (deposits) | -0.1 | 2.1 | 2.6 | 4.9 | 11.1 |
| | | | | | |
| Annual percentage growth rates | | | | | |
| M1 | 15.5 | 8.3 | 13.1 | 14.7 | 12.2 |
| M2 | 8.1 | 5.8 | 8.1 | 10.6 | 12.2 |
| Loans to corporations and households | 11.8 | 15.3 | 20.8 | 21.6 | 25.5 |
| M2-M1 (deposits) | 1.2 | 3.3 | 2.6 | 5.7 | 12.0 |

**Table 8**

**INTEREST RATES ON INTERBANK DEPOSITS**

percentages

| | 2003<br>12 | 2004<br>12 | 2005<br>12 | 2006<br>12 | 2007<br>12 |
|---|---|---|---|---|---|
| **1. Average PRIBOR** [1] | | | | | |
| - 1 day | 1.98 | 2.49 | 2.00 | 2.48 | 3.40 |
| - 7 day | 2.02 | 2.51 | 2.04 | 2.51 | 3.58 |
| - 14 day | 2.03 | 2.51 | 2.04 | 2.51 | 3.63 |
| - 1 month | 2.04 | 2.53 | 2.05 | 2.52 | 3.98 |
| - 2 month | 2.06 | 2.55 | 2.10 | 2.54 | 4.02 |
| - 3 month | 2.08 | 2.57 | 2.17 | 2.56 | 4.05 |
| - 6 month | 2.13 | 2.67 | 2.33 | 2.67 | 4.09 |
| - 9 month | 2.22 | 2.76 | 2.44 | 2.79 | 4.15 |
| - 12 month | 2.30 | 2.85 | 2.53 | 2.89 | 4.20 |
| **2. Average PRIBID** [1] | | | | | |
| - 1 day | 1.88 | 2.39 | 1.90 | 2.38 | 3.30 |
| - 7 day | 1.92 | 2.41 | 1.94 | 2.41 | 3.48 |
| - 14 day | 1.93 | 2.41 | 1.94 | 2.41 | 3.53 |
| - 1 month | 1.94 | 2.43 | 1.95 | 2.42 | 3.88 |
| - 2 month | 1.96 | 2.45 | 2.00 | 2.44 | 3.92 |
| - 3 month | 1.98 | 2.47 | 2.07 | 2.46 | 3.95 |
| - 6 month | 2.03 | 2.57 | 2.23 | 2.57 | 3.99 |
| - 9 month | 2.12 | 2.66 | 2.34 | 2.69 | 4.05 |
| - 12 month | 2.20 | 2.75 | 2.43 | 2.79 | 4.10 |

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

**Table 9**

**FRA RATES** percentages; monthly averages

| | 2003 12 | 2004 12 | 2005 12 | 2006 12 | 2007 12 |
|---|---|---|---|---|---|
| 3 * 6 | 2.23 | 2.74 | 2.46 | 2.71 | 4.15 |
| 3 * 9 | 2.36 | 2.81 | 2.57 | 2.83 | 4.16 |
| 6 * 9 | 2.47 | 2.85 | 2.66 | 2.92 | 4.15 |
| 6 * 12 | 2.64 | 2.92 | 2.74 | 3.02 | 4.17 |
| 9 * 12 | 2.77 | 2.97 | 2.79 | 3.08 | 4.16 |
| | | | | | |
| 9*12 - 3*6 spread | 0.55 | 0.24 | 0.33 | 0.37 | 0.02 |
| 6*12 - 3*9 spread | 0.28 | 0.12 | 0.17 | 0.19 | 0.02 |

**IRS RATES** percentages; monthly averages

| | 2003 12 | 2004 12 | 2005 12 | 2006 12 | 2007 12 |
|---|---|---|---|---|---|
| 1Y | 2.41 | 2.82 | 2.56 | 2.86 | 4.19 |
| 2Y | 2.98 | 3.06 | 2.82 | 3.09 | 4.20 |
| 3Y | 3.38 | 3.27 | 3.00 | 3.21 | 4.22 |
| 4Y | 3.69 | 3.45 | 3.13 | 3.31 | 4.26 |
| 5Y | 3.93 | 3.62 | 3.25 | 3.40 | 4.30 |
| 6Y | 4.13 | 3.77 | 3.33 | 3.46 | 4.34 |
| 7Y | 4.29 | 3.89 | 3.40 | 3.52 | 4.38 |
| 8Y | 4.43 | 4.00 | 3.46 | 3.58 | 4.42 |
| 9Y | 4.54 | 4.09 | 3.52 | 3.63 | 4.47 |
| 10Y | 4.64 | 4.17 | 3.58 | 3.68 | 4.52 |
| 15Y | 4.97 | 4.40 | 3.78 | 3.83 | 4.71 |
| 20Y | 5.11 | 4.54 | 3.88 | 3.89 | 4.76 |
| | | | | | |
| 5Y - 1Y spread | 1.52 | 0.80 | 0.69 | 0.54 | 0.11 |
| 10Y - 1Y spread | 2.23 | 1.35 | 1.02 | 0.82 | 0.33 |

**Table 10**

**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 | 6.1 | 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 | 6.1 | 2.2 | 0.3 | 0.9 | 3.5 | -0.3 | -1.7 | -1.2 | 1.4 |
| 7/07 | 2.8 | 3.6 | 6.3 | 2.2 | 0.5 | 1.3 | 3.9 | -0.1 | -1.2 | -0.5 | 2.1 |
| 8/07 | 3.0 | 3.7 | 6.5 | 2.3 | 0.6 | 1.3 | 4.0 | -0.1 | -0.7 | 0.0 | 2.7 |
| 9/07 | 3.3 | 3.8 | 6.5 | 2.4 | 0.5 | 1.0 | 3.6 | -0.4 | -0.7 | -0.2 | 2.4 |
| 10/07 | 3.3 | 3.8 | 6.7 | 2.5 | -0.7 | -0.2 | 2.5 | -1.5 | -1.1 | -0.5 | 2.2 |
| 11/07 | 3.3 | 4.0 | 6.8 | 2.5 | -1.6 | -1.0 | 1.7 | -2.4 | -2.0 | -1.3 | 1.3 |
| 12/07 | 3.6 | 4.2 | — | — | -1.7 | -1.1 | — | — | -1.6 | -1.0 | — |

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

**Table 11**

**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 | 2.8 | -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 | 2.8 | -1.0 | -0.3 | 0.3 | 3.0 | -0.8 |
| 7/07 | -0.3 | 0.5 | 3.1 | -0.9 | — | — | — | — |
| 8/07 | -0.6 | 0.1 | 2.8 | -1.2 | — | — | — | — |
| 9/07 | -0.9 | -0.4 | 2.2 | -1.7 | -0.3 | 0.2 | 2.8 | -1.2 |
| 10/07 | -1.0 | -0.4 | 2.3 | -1.7 | — | — | — | — |
| 11/07 | -0.9 | -0.3 | 2.4 | -1.8 | — | — | — | — |
| 12/07 | -0.8 | -0.3 | — | — | -1.2 | -0.6 | — | — |

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 12**

**KORUNA INTEREST RATES (stock of business)**

percentages

| | 2003 12 | 2004 12 | 2005 12 | 2006 12 | 2007 11 |
|---|---|---|---|---|---|
| **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 | 6.61 |
| - maturity up to 1 year | 11.21 | 12.82 | 12.96 | 13.75 | 13.31 |
| - maturity over 1 year and up to 5 years | 10.17 | 12.40 | 11.43 | 11.35 | 12.34 |
| - maturity over 5 years | 6.65 | 6.39 | 5.96 | 5.84 | 5.79 |
| for consumption - total | 13.83 | 14.89 | 13.88 | 13.59 | 13.12 |
| - maturity up to 1 year | 14.26 | 15.48 | 16.22 | 17.31 | 16.04 |
| - maturity over 1 year and up to 5 years | 13.86 | 15.17 | 14.94 | 14.67 | 15.07 |
| - 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 | 4.87 |
| - maturity up to 1 year | 6.24 | 4.48 | 4.29 | 5.39 | 6.35 |
| - maturity over 1 year and up to 5 years | 7.05 | 6.57 | 6.22 | 6.15 | 6.18 |
| - maturity over 5 years | 6.09 | 5.89 | 5.19 | 4.88 | 4.85 |
| other - total | 7.80 | 7.50 | 7.09 | 6.87 | 6.75 |
| - maturity up to 1 year | 8.49 | 8.96 | 9.09 | 9.52 | 10.01 |
| - maturity over 1 year and up to 5 years | 8.02 | 7.63 | 7.17 | 7.74 | 8.25 |
| - maturity over 5 years | 7.02 | 6.58 | 5.79 | 5.51 | 5.58 |
| **Non-financial corporations (S.11) - total** | 4.53 | 4.75 | 4.20 | 4.45 | 5.24 |
| - maturity up to 1 year | 4.08 | 4.35 | 3.84 | 4.23 | 5.14 |
| - maturity over 1 year and up to 5 years | 4.64 | 4.68 | 4.18 | 4.38 | 5.27 |
| - maturity over 5 years | 5.14 | 5.39 | 4.72 | 4.74 | 5.35 |
| **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 | 1.36 |
| overnight | 0.50 | 0.52 | 0.40 | 0.41 | 0.54 |
| with agreed maturity - total | 2.02 | 2.13 | 1.92 | 1.96 | 2.05 |
| - with agreed maturity up to 2 years | 0.96 | 1.37 | 1.03 | 1.49 | 1.98 |
| - with agreed maturity over 2 years | 2.90 | 2.69 | 2.50 | 2.31 | 2.11 |
| redeemable at notice - total | 1.26 | 1.63 | 1.71 | 1.97 | 2.11 |
| - redeemable at notice up to 3 months | 1.67 | 2.14 | 2.27 | 2.34 | 2.41 |
| - redeemable at notice over 3 months | 0.98 | 1.12 | 0.81 | 1.00 | 1.08 |
| **Non-financial corporations (S.11) - total** | 0.85 | 1.21 | 0.91 | 1.18 | 1.67 |
| overnight | 0.64 | 0.68 | 0.52 | 0.72 | 1.06 |
| with agreed maturity - total | 1.50 | 2.08 | 1.64 | 2.09 | 2.77 |
| - with agreed maturity up to 2 years | 1.49 | 2.05 | 1.61 | 2.08 | 2.78 |
| - with agreed maturity over 2 years | 3.04 | 3.12 | 2.47 | 2.28 | 2.16 |
| redeemable at notice - total | 1.17 | 1.60 | 1.14 | 1.64 | 1.81 |
| - redeemable at notice up to 3 months | 1.14 | 1.49 | 1.07 | 1.53 | 1.71 |
| - redeemable at notice over 3 months | 1.32 | 2.26 | 1.64 | 2.21 | 2.67 |

**Table 13**

**BALANCE OF PAYMENTS [1)]**

in CZK millions

| | 2003 Q1 - 4 | 2004 Q1 - 4 | 2005 Q1 - 4 | 2006 Q1 - 4 | 2007 [2)] Q3 |
|---|---|---|---|---|---|
| **A. Current account** | -160,614.6 | -147,455.7 | -48,500.2 | -100,324.9 | -47,766.9 |
| Balance of trade | -69,793.0 | -13,384.0 | 59,369.5 | 68,213.0 | 18,955.4 |
| exports | 1,370,930.0 | 1,722,657.4 | 1,868,585.8 | 2,144,005.5 | 600,305.7 |
| imports | 1,440,723.0 | 1,736,041.4 | 1,809,216.3 | 2,075,792.5 | 581,350.3 |
| Services | 13,236.7 | 16,564.4 | 36,542.0 | 34,572.8 | 13,212.2 |
| credit | 219,151.1 | 247,084.8 | 282,016.3 | 300,370.9 | 87,637.1 |
| transport | 60,556.3 | 69,859.0 | 76,701.5 | 84,292.7 | 25,713.7 |
| travel | 100,310.1 | 107,231.8 | 111,839.3 | 113,125.0 | 34,399.3 |
| others | 58,284.7 | 69,994.0 | 93,475.5 | 102,953.2 | 27,524.1 |
| debit | 205,914.4 | 230,520.4 | 245,474.3 | 265,798.1 | 74,424.9 |
| transport | 33,725.7 | 47,571.4 | 56,254.1 | 62,008.2 | 18,139.9 |
| travel | 54,419.2 | 58,398.0 | 57,777.6 | 60,015.4 | 22,857.9 |
| others | 117,769.5 | 124,551.0 | 131,442.6 | 143,774.5 | 33,427.1 |
| Income | -119,858.4 | -156,637.9 | -155,700.6 | -183,431.3 | -75,351.0 |
| credit | 75,508.3 | 87,206.1 | 105,728.7 | 121,355.9 | 36,716.2 |
| debit | 195,366.7 | 243,844.0 | 261,429.3 | 304,787.2 | 112,067.2 |
| Current transfers | 15,800.1 | 6,001.8 | 11,288.9 | -19,679.4 | -4,583.5 |
| credit | 46,976.7 | 53,050.6 | 78,545.3 | 65,872.5 | 19,221.2 |
| debit | 31,176.6 | 47,048.8 | 67,256.4 | 85,551.9 | 23,804.7 |
| **B. Capital account** | -82.2 | -14,186.5 | 4,689.3 | 8,467.0 | 3,494.3 |
| credit | 198.2 | 5,608.2 | 5,525.2 | 14,269.5 | 3,809.7 |
| debit | 280.4 | 19,794.7 | 835.9 | 5,802.5 | 315.4 |
| *Total A + B* | *-160,696.8* | *-161,642.2* | *-43,810.9* | *-91,857.9* | *-44,272.6* |
| **C. Financial account** | 157,093.5 | 177,312.0 | 154,767.4 | 111,611.3 | 40,148.0 |
| Direct investment | 53,500.3 | 101,776.3 | 279,630.5 | 104,307.1 | 37,496.8 |
| abroad | -5,815.7 | -26,067.3 | 449.0 | -30,370.0 | -8,194.7 |
| equity capital and reinvested earnings | -3,124.6 | -20,260.0 | -4,262.8 | -29,228.4 | -6,858.8 |
| other capital | -2,691.1 | -5,807.3 | 4,711.8 | -1,141.6 | -1,335.9 |
| in the Czech Republic | 59,316.0 | 127,843.6 | 279,181.5 | 134,677.1 | 45,691.5 |
| equity capital and reinvested earnings | 59,350.4 | 121,482.9 | 262,471.8 | 117,628.4 | 54,455.4 |
| other capital | -34.4 | 6,360.7 | 16,709.7 | 17,048.7 | -8,763.9 |
| Portfolio investment | -35,719.1 | 53,032.5 | -81,243.8 | -26,882.5 | -40,303.3 |
| assets | -83,892.7 | -70,245.2 | -82,095.7 | -68,383.5 | -30,091.5 |
| equity securities | 5,630.5 | -36,457.1 | -35,342.4 | -43,559.2 | -23,863.8 |
| debt securities | -89,523.2 | -33,788.1 | -46,753.3 | -24,824.3 | -6,227.7 |
| liabilities | 48,173.6 | 123,277.7 | 851.9 | 41,501.0 | -10,211.8 |
| equity securities | 30,133.5 | 19,558.6 | -36,408.9 | 5,758.0 | -13,660.2 |
| debt securities | 18,040.1 | 103,719.1 | 37,260.8 | 35,743.0 | 3,448.4 |
| Financial derivatives | 3,860.1 | -3,208.0 | -2,798.6 | -6,323.5 | -11,729.0 |
| assets | 7,083.7 | -15,565.8 | -2,860.9 | -10,899.8 | -8,077.5 |
| liabilities | -3,223.6 | 12,357.8 | 62.3 | 4,576.3 | -3,651.5 |
| Other investment | 135,452.2 | 25,711.2 | -40,820.7 | 40,510.2 | 54,683.5 |
| assets | 67,071.3 | -30,507.4 | -114,430.6 | -35,522.5 | 17,172.9 |
| long-term | 1,141.3 | 20,434.2 | -16,338.0 | -6,060.0 | -12,933.6 |
| CNB | — | -184.9 | -176.3 | — | — |
| commercial banks | -999.9 | 505.0 | -24,641.7 | -10,715.5 | -11,077.4 |
| government | 5,714.3 | 22,790.7 | 14,056.5 | 4,983.6 | -537.4 |
| other sectors | -3,573.1 | -2,676.6 | -5,576.5 | -328.1 | -1,318.8 |
| short-term | 65,930.0 | -50,941.6 | -98,092.6 | -29,462.5 | 30,106.5 |
| commercial banks | 44,971.2 | -34,248.5 | -87,137.0 | 24,770.1 | 28,985.6 |
| government | 2,193.8 | 92.9 | 9.4 | — | — |
| other sectors | 18,765.0 | -16,786.0 | -10,965.0 | -54,232.6 | 1,120.9 |
| liabilities | 68,380.9 | 56,218.6 | 73,609.9 | 76,032.7 | 37,510.6 |
| long-term | 26,361.6 | 36,550.9 | 49,022.1 | 51,095.2 | 16,004.1 |
| CNB | -20.4 | -20.5 | -19.1 | -18.1 | -9.0 |
| commercial banks | -5,038.0 | -1,410.8 | 311.1 | 12,733.4 | 13,220.9 |
| government | 10,304.7 | 10,296.1 | 20,809.1 | 9,550.3 | 308.7 |
| other sectors | 21,115.3 | 27,686.1 | 27,921.0 | 28,829.6 | 2,483.5 |
| short-term | 42,019.3 | 19,667.7 | 24,587.8 | 24,937.5 | 21,506.5 |
| CNB | -21.4 | 843.7 | 5,060.1 | -4,147.6 | 1,192.1 |
| commercial banks | 37,899.4 | -15,344.5 | 14,808.8 | 2,369.2 | 25,124.6 |
| government | — | — | — | — | — |
| other sectors | 4,141.3 | 34,168.5 | 4,718.9 | 26,715.9 | -4,810.2 |
| *Total A + B + C* | *-3,603.3* | *15,669.8* | *110,956.5* | *19,753.4* | *-4,124.6* |
| **D. Net errors and omissions, valuation changes** | 16,506.7 | -8,887.6 | -18,104.9 | -17,679.0 | 9,367.2 |
| *Total A + B + C + D* | *12,903.4* | *6,782.2* | *92,851.6* | *2,074.4* | *5,242.6* |
| **E. Change in reserves (- increase)** | -12,903.4 | -6,782.2 | -92,851.6 | -2,074.4 | -5,242.6 |

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

**Table 14**

**INTERNATIONAL INVESTMENT POSITION** in CZK millions

| | 2003 31 Dec. | 2004 31 Dec. | 2005 31 Dec. | 2006 31 Dec. | 2007[1] 30 Sep. |
|---|---|---|---|---|---|
| **Assets** | 1,537,284.6 | 1,549,333.7 | 1,875,403.8 | 1,894,747.4 | 2,061,361.8 |
| Direct investment abroad | 58,581.5 | 84,087.4 | 88,772.7 | 105,600.0 | 120,680.0 |
| - equity capital | 50,965.5 | 70,664.0 | 80,061.1 | 96,510.0 | 107,805.0 |
| - other capital | 7,616.0 | 13,423.4 | 8,711.6 | 9,090.0 | 12,875.0 |
| Portfolio investment | 343,968.7 | 372,237.6 | 467,808.5 | 531,990.4 | 628,274.3 |
| - equity securities | 47,337.7 | 76,121.3 | 146,957.6 | 202,122.7 | 265,716.7 |
| - debt securities | 296,631.0 | 296,116.3 | 320,850.9 | 329,867.7 | 362,557.6 |
| Financial derivatives | 24,129.5 | 39,695.3 | 42,556.2 | 53,456.0 | 52,982.0 |
| Other investment | 419,090.0 | 417,071.9 | 549,564.4 | 547,063.3 | 619,456.3 |
| long-term | 157,598.6 | 118,432.7 | 136,314.1 | 129,684.5 | 160,975.9 |
| - CNB | 468.4 | 600.0 | 3,184.5 | 2,993.8 | 3,018.0 |
| - commercial banks | 66,121.3 | 58,137.8 | 83,231.1 | 87,666.1 | 119,946.2 |
| - government | 79,483.9 | 48,574.9 | 38,408.5 | 29,894.6 | 28,591.7 |
| - other sectors | 11,525.0 | 11,120.0 | 11,490.0 | 9,130.0 | 9,420.0 |
| short-term | 261,491.4 | 298,639.2 | 413,250.3 | 417,378.8 | 458,480.4 |
| - CNB | 98.8 | 71.7 | 71.1 | 131.3 | 158.0 |
| - commercial banks | 161,150.2 | 184,588.0 | 273,879.1 | 233,927.5 | 273,902.4 |
| of which: gold and foreign exchange | 115,884.8 | 128,119.8 | 198,042.8 | 166,580.8 | 133,035.6 |
| - government | 102.4 | 9.5 | 0.1 | — | — |
| - other sectors | 100,140.0 | 113,970.0 | 139,300.0 | 183,320.0 | 184,420.0 |
| CNB reserves | 691,514.9 | 636,241.5 | 726,702.0 | 656,637.7 | 639,969.2 |
| - gold | 4,784.3 | 4,253.9 | 5,526.8 | 5,690.9 | 6,123.7 |
| - SDR | 238.7 | 118.0 | 289.8 | 346.0 | 350.0 |
| - reserve position in the IMF | 11,949.9 | 9,137.5 | 4,447.7 | 2,324.6 | 1,640.5 |
| - foreign exchange | 674,451.8 | 622,606.4 | 716,315.2 | 648,192.1 | 624,640.3 |
| - other reserve assets | 90.2 | 125.7 | 122.5 | 84.1 | 7,214.7 |
| **Liabilities** | 2,064,768.3 | 2,374,328.4 | 2,710,646.3 | 2,928,764.2 | 3,202,314.6 |
| Direct investment in the Czech Republic | 1,161,783.6 | 1,280,594.8 | 1,491,564.0 | 1,617,053.0 | 1,734,214.9 |
| - equity capital | 1,009,391.8 | 1,121,842.3 | 1,316,101.8 | 1,433,723.0 | 1,578,274.9 |
| - other capital | 152,391.8 | 158,752.5 | 175,462.2 | 183,330.0 | 155,940.0 |
| Portfolio investment | 223,620.4 | 381,019.4 | 437,806.0 | 487,994.5 | 544,719.5 |
| - equity securities | 140,788.6 | 208,872.1 | 220,495.8 | 241,594.8 | 276,604.3 |
| - debt securities | 82,831.8 | 172,147.3 | 217,310.2 | 246,399.7 | 268,115.2 |
| Financial derivatives | 19,448.3 | 31,806.1 | 31,868.4 | 36,444.7 | 39,369.8 |
| Other investment | 659,916.0 | 680,908.1 | 749,407.9 | 787,272.0 | 884,010.4 |
| long-term | 360,279.2 | 373,456.4 | 417,645.7 | 448,883.2 | 480,547.5 |
| - CNB | 96.1 | 70.2 | 47.8 | 27.2 | 8.9 |
| - commercial banks | 58,056.3 | 52,020.8 | 51,639.8 | 62,263.6 | 85,252.3 |
| - government | 22,456.0 | 32,065.4 | 52,322.1 | 61,236.4 | 63,720.8 |
| - other sectors | 279,670.8 | 289,300.0 | 313,636.0 | 325,356.0 | 331,565.5 |
| short-term | 299,636.8 | 307,451.7 | 331,762.2 | 338,388.8 | 403,462.9 |
| - CNB | 22.8 | 866.5 | 5,926.5 | 1,779.0 | 1,839.0 |
| - commercial banks | 208,534.0 | 185,025.2 | 201,315.7 | 193,934.8 | 259,593.9 |
| - government | — | — | — | — | — |
| - other sectors | 91,080.0 | 121,560.0 | 124,520.0 | 142,675.0 | 142,030.0 |
| **Net investment position** | -527,483.7 | -824,994.7 | -835,242.5 | -1,034,016.8 | -1,140,952.8 |

1) Preliminary data

**Table 15**

| EXTERNAL DEBT | | | | | in CZK millions |
|---|---|---|---|---|---|
| | 2003<br>31 Dec. | 2004<br>31 Dec. | 2005<br>31 Dec. | 2006<br>31 Dec. | 2007[1]<br>30 Sep. |
| **Debt in convertible currencies** | 895,139.6 | 1,011,807.9 | 1,142,180.3 | 1,217,001.7 | 1,308,065.6 |
| of which: | | | | | |
| Long-term | 535,995.9 | 667,327.6 | 783,533.1 | 844,844.5 | 881,412.1 |
| by debtor | | | | | |
| - CNB | 96.1 | 70.2 | 47.8 | 27.2 | 8.9 |
| - commercial banks | 73,276.4 | 64,346.5 | 65,418.9 | 76,426.6 | 104,138.8 |
| - government | 69,029.9 | 147,729.1 | 221,003.4 | 246,569.8 | 261,092.5 |
| - other sectors | 393,593.5 | 455,181.8 | 497,063.0 | 521,820.9 | 516,171.9 |
| by creditor | | | | | |
| - foreign banks | 251,535.3 | 269,081.3 | 276,594.3 | 304,855.9 | 329,881.4 |
| - 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 | 109,765.5 |
| - suppliers and direct investors | 109,287.9 | 143,301.2 | 170,586.6 | 170,625.0 | 160,050.0 |
| - other investors | 91,393.1 | 170,082.7 | 221,528.5 | 250,701.5 | 273,029.2 |
| Short-term | 359,143.7 | 344,480.3 | 358,647.2 | 372,157.2 | 426,653.5 |
| by debtor | | | | | |
| - CNB | 22.8 | 866.5 | 5,926.5 | 1,779.0 | 1,839.0 |
| - commercial banks | 210,017.0 | 188,495.9 | 202,616.9 | 196,648.2 | 263,294.1 |
| - government | 710.0 | 3,334.6 | 1,102.4 | 350.0 | 890.4 |
| - other sectors | 148,393.9 | 151,783.3 | 149,001.4 | 173,380.0 | 160,630.0 |
| by creditor | | | | | |
| - foreign banks | 218,436.1 | 202,372.6 | 197,820.7 | 192,668.8 | 241,896.2 |
| - multilateral institutions | — | 861.3 | 5,918.8 | 1,768.2 | 1,833.2 |
| - suppliers and direct investors | 105,563.9 | 98,611.3 | 102,235.6 | 123,495.0 | 108,310.0 |
| - other investors | 35,143.7 | 42,635.1 | 52,672.1 | 54,225.2 | 74,614.1 |
| **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 | 1,308,065.6 |
| of which: | | | | | |
| - long-term | 535,995.9 | 667,327.6 | 783,533.1 | 844,844.5 | 881,412.1 |
| - short-term | 359,143.7 | 344,480.3 | 358,647.2 | 372,157.2 | 426,653.5 |
| **Total long-term debt** | 535,995.9 | 667,327.6 | 783,533.1 | 844,844.5 | 881,412.1 |
| 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 | 354,307.5 |
| - liabilities of entities with majority private capital | 313,875.0 | 395,125.5 | 461,034.7 | 506,657.2 | 527,104.6 |

1) Preliminary data

**Table 16**

## EXCHANGE RATES

in CZK; foreign exchange market rates

| A. NOMINAL RATE | 2003 1 - 12 | 2004 1 - 12 | 2005 1 - 12 | 2006 1 - 12 | 2007 10 - 12 |
|---|---|---|---|---|---|
| **CZK exchange rate against selected currencies** | | | | | |
| - annual/quarterly averages | | | | | |
| 1 EUR | 31.84 | 31.90 | 29.78 | 28.34 | 26.83 |
| 1 USD | 28.23 | 25.70 | 23.95 | 22.61 | 18.53 |
| 100 SKK | 76.75 | 79.69 | 77.15 | 76.16 | 80.28 |
| | | | | | |
| | **12** | **12** | **12** | **12** | **12** |
| - monthly averages | | | | | |
| 1 EUR | 32.31 | 30.65 | 28.98 | 27.78 | 26.30 |
| 1 USD | 26.32 | 22.87 | 24.44 | 21.02 | 18.04 |
| 100 SKK | 78.57 | 78.81 | 76.51 | 79.44 | 78.77 |
| | | | | | |
| | **31 Dec.** | **31 Dec.** | **30 Dec.** | **29 Dec.** | **31 Dec.** |
| - last day of the month | | | | | |
| 1 EUR | 32.41 | 30.47 | 29.01 | 27.50 | 26.62 |
| 1 USD | 25.65 | 22.37 | 24.59 | 20.88 | 18.08 |
| 100 SKK | 78.71 | 78.63 | 76.57 | 79.86 | 79.18 |

| B. NOMINAL EFFECTIVE RATE | 2003 | 2004 | 2005 | 2006 | 2007 12 |
|---|---|---|---|---|---|
| CZK nominal effective exchange rate (percentages) | | | | | |
| (2005=100) | | | | | |
| weights - foreign trade turnover | 94.0 | 94.3 | 100.0 | 104.6 | 112.9 |
| weights - foreign trade turnover SITC 5-8 | 93.8 | 94.2 | 100.0 | 105.0 | 113.3 |

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 11 |
|---|---|---|---|---|---|
| CZK real effective exchange rate (percentages) | | | | | |
| (2005=100) | | | | | |
| a) industrial producer prices | | | | | |
| weights - foreign trade turnover | 93.1 | 95.8 | 100.0 | 102.0 | 110.3 |
| weights - foreign trade turnover SITC 5-8 | 92.6 | 95.5 | 100.0 | 102.3 | 111.1 |
| b) consumer prices | | | | | |
| weights - foreign trade turnover | 95.4 | 95.3 | 100.0 | 104.3 | 111.7 |
| weights - foreign trade turnover SITC 5-8 | 94.7 | 94.9 | 100.0 | 104.7 | 112.6 |

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 17**

| PUBLIC FINANCES | | | | | in CZK billions |
|---|---|---|---|---|---|
| | 2003<br>1 - 12 | 2004<br>1 - 12 | 2005<br>1 - 12 | 2006<br>1 - 12 | 2007<br>1 - 12 |
| **STATE BUDGET** | | | | | |
| **Total revenue** | 699.7 | 769.2 | 866.5 | 923.1 | 1,025.9 |
| Tax revenue | 667.5 | 716.7 | 770.4 | 801.6 | 900.7 |
| Taxes on income, profits and capital gains | 172.9 | 180.7 | 195.0 | 187.1 | 216.9 |
| Domestic taxes on goods and services | 198.4 | 223.2 | 250.4 | 266.1 | 298.2 |
| - value-added taxes | 125.6 | 140.4 | 146.8 | 153.5 | 166.6 |
| - excises | 72.9 | 82.8 | 103.6 | 112.6 | 131.6 |
| Taxes on property | 8.8 | 10.4 | 8.1 | 8.5 | 10.6 |
| Social and health security contributions and payroll taxes | 272.4 | 293.3 | 311.2 | 333.7 | 367.2 |
| Non-tax and capital incomes and received subsidies | 32.2 | 52.5 | 96.1 | 121.5 | 125.2 |
| | | | | | |
| **Total expenditure** | 808.7 | 862.9 | 922.8 | 1,020.6 | 1,092.3 |
| Current expenditure | 745.4 | 796.8 | 840.8 | 912.1 | 973.9 |
| Capital expenditure | 63.3 | 66.1 | 82.0 | 108.5 | 118.4 |
| | | | | | |
| Public budgets (balance in IMF GFS methodology) | -127.7 | -89.4 | 0.6 | -1,48.9 | __ |
| state budget | -104.9 | -65.0 | -61.1 | -1,07.0 | -66.4 |
| 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 18**

## CAPITAL MARKET

last day of the month in points

| A. STOCK MARKET INDICES | 2003 12 | 2004 12 | 2005 12 | 2006 12 | 2007 12 |
|---|---|---|---|---|---|
| **BCPP** | | | | | |
| PX | 659.1 | 1,032.0 | 1,473.0 | 1,588.9 | 1,815.1 |
| PX-GLOB | 816.9 | 1,232.7 | 1,811.3 | 1,987.4 | 2,268.4 |
| | | | | | |
| **RM-SYSTÉM** | | | | | |
| PK-30 | 947.5 | 1,443.5 | 2,365.0 | 2,595.3 | 3,404.4 |

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 12 |
|---|---|---|---|---|---|
| **BCPP** | | | | | |
| Monthly trade volumes | 98,640.0 | 90,610.5 | 96,160.5 | 112,400.0 | 129,530.1 |
| of which: | | | | | |
| a) shares | 28,296.0 | 46,210.3 | 56,180.3 | 58,915.7 | 70,878.9 |
| b) bonds | 70,344.0 | 44,400.2 | 39,980.2 | 53,484.3 | 58,651.2 |
| | | | | | |
| **RM-SYSTÉM** | | | | | |
| Monthly trade volumes | 1,103.0 | 335.8 | 286.7 | 523.0 | 457.4 |
| of which: | | | | | |
| a) shares | 1,082.5 | 332.7 | 220.9 | 440.2 | 457.4 |
| b) units | 3.7 | 3.1 | 0.0 | 1.1 | 0.0 |
| c) bonds | 16.8 | 0.0 | 65.8 | 81.7 | 0.0 |

**Table 19**

**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 | — | — |
| 27 July | 3.00 | 2.00 | 4.00 | — | — |
| 31 August | 3.25 | 2.25 | 4.25 | — | — |
| 30 November | 3.50 | 2.50 | 4.50 | — | — |

**Table 20**

**MACROECONOMIC AGGREGATES**

in CZK millions; annual percentage changes; constant 2000 prices

| | 2003 Q1 - 4 | 2004 Q1 - 4 | 2005 Q1 - 4 | 2006 Q1 - 4 | 2007 Q3 |
|---|---|---|---|---|---|
| **Gross domestic product** | | | | | |
| - in CZK millions | 2,367,818 | 2,474,006 | 2,631,670 | 2,799,044 | 751,466 |
| - percentages | 3.6 | 4.5 | 6.4 | 6.4 | 6.0 |
| **Final consumption** | | | | | |
| - in CZK millions | 1,817,625 | 1,834,457 | 1,876,886 | 1,947,559 | 507,688 |
| - percentages | 6.3 | 0.9 | 2.3 | 3.8 | 3.7 |
| of which: | | | | | |
| Households | | | | | |
| - in CZK millions | 1,258,158 | 1,294,377 | 1,324,008 | 1,395,130 | 375,343 |
| - percentages | 6.0 | 2.9 | 2.3 | 5.4 | 5.6 |
| Government | | | | | |
| - in CZK millions | 545,999 | 526,656 | 538,452 | 538,554 | 130,264 |
| - percentages | 7.1 | -3.5 | 2.2 | 0.0 | -0.4 |
| Non-profit institutions | | | | | |
| - in CZK millions | 13,362 | 14,579 | 15,563 | 17,313 | 4,431 |
| - percentages | 6.2 | 9.1 | 6.7 | 11.2 | 2.0 |
| **Gross capital formation** | | | | | |
| - in CZK millions | 709,600 | 773,916 | 770,933 | 855,373 | 247,867 |
| - percentages | -1.4 | 9.1 | -0.4 | 11.0 | 9.4 |
| of which: | | | | | |
| Fixed capital | | | | | |
| - in CZK millions | 689,117 | 716,285 | 732,585 | 772,802 | 208,798 |
| - percentages | 0.4 | 3.9 | 2.3 | 5.5 | 5.7 |
| Changes in inventories | | | | | |
| - in CZK millions | 15,642 | 54,706 | 35,613 | 79,804 | 38,305 |
| Acquisitions less disposals of valuables | | | | | |
| - in CZK millions | 4,841 | 2,925 | 2,735 | 2,767 | 764 |
| - percentages | 40.8 | -39.6 | -6.5 | 1.2 | 11.5 |
| | | | | | |
| **Foreign trade** | | | | | |
| of which: | | | | | |
| Exports of goods | | | | | |
| - in CZK millions | 1,479,795 | 1,820,657 | 2,033,180 | 2,358,978 | 651,000 |
| - percentages | 9.3 | 23.0 | 11.7 | 16.0 | 15.2 |
| Exports of services | | | | | |
| - in CZK millions | 212,807 | 226,614 | 255,889 | 266,054 | 76,932 |
| - percentages | -4.2 | 6.5 | 12.9 | 4.0 | 11.9 |
| Imports of goods | | | | | |
| - in CZK millions | 1,623,393 | 1,928,984 | 2,027,793 | 2,331,042 | 648,627 |
| - percentages | 9.0 | 18.8 | 5.1 | 15.0 | 14.7 |
| Imports of services | | | | | |
| - in CZK millions | 235,915 | 263,438 | 273,993 | 289,903 | 80,962 |
| - percentages | 1.8 | 11.7 | 4.0 | 5.8 | 10.2 |
| | | | | | |
| **Final domestic demand** | | | | | |
| - in CZK millions | 2,506,742 | 2,550,742 | 2,609,471 | 2,720,361 | 716,486 |
| - percentages | 4.6 | 1.8 | 2.3 | 4.2 | 4.3 |
| **Aggregate domestic demand** | | | | | |
| - in CZK millions | 2,527,225 | 2,608,373 | 2,647,819 | 2,802,932 | 755,555 |
| - percentages | 4.0 | 3.2 | 1.5 | 5.9 | 5.5 |
| **Gross domestic product at current prices** | | | | | |
| - in CZK millions | 2,577,110 | 2,814,762 | 2,987,722 | 3,231,576 | 900,022 |
| - percentages | 4.6 | 9.2 | 6.1 | 8.2 | 9.5 |

Source: CZSO

**Table 21**

## 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 Q3 |
|---|---|---|---|---|---|
| Current income | 5.9 | 4.9 | 4.3 | 7.5 | 8.8 |
| of which: | | | | | |
| - gross operating surplus and mixed income | 7.7 | 5.7 | -1.0 | 5.8 | 4.9 |
| - compensation of employees | 5.5 | 5.7 | 6.2 | 7.1 | 8.2 |
| - property income | 5.3 | -1.0 | 1.2 | 16.6 | 11.4 |
| - social benefits other than social transfers in kind | 3.6 | 3.4 | 4.7 | 8.4 | 15.9 |
| - other current transfers | 10.9 | 2.2 | 7.9 | 8.0 | 4.7 |
| | | | | | |
| Current expenditure | 9.5 | 7.5 | 4.6 | 9.1 | 8.8 |
| of which: | | | | | |
| - property income | 21.3 | 12.4 | -5.4 | 23.7 | 48.7 |
| - current taxes on income, wealth, etc. | 12.1 | 7.7 | 1.2 | 9.9 | 1.6 |
| - social contributions | 7.2 | 8.3 | 6.5 | 8.9 | 10.0 |
| - other current transfers | 12.5 | 2.8 | 1.9 | 6.0 | 2.5 |
| | | | | | |
| Gross disposable income | 4.3 | 3.6 | 4.2 | 6.7 | 8.8 |
| Change in net equity of households in pension funds reserves | 15.4 | 29.1 | 11.1 | 22.0 | 3.5 |
| Individual consumption expenditure | 6.5 | 5.6 | 3.1 | 7.7 | 8.3 |
| Gross saving | -15.5 | -17.8 | 24.9 | -4.7 | 21.1 |
| Gross saving rate | 8.03 | 5.89 | 6.45 | 5.75 | 4.44 |
| (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 Q3 |
|---|---|---|---|---|---|
| Whole-economy nominal wage | 6.4 | 6.2 | 5.3 | 6.4 | 7.4 |
| Business sector | 5.5 | 6.3 | 5.3 | 6.7 | 7.4 |
| Non-business sector | 9.8 | 5.7 | 5.7 | 5.4 | 7.5 |
| | | | | | |
| Whole-economy real wage | 6.3 | 3.3 | 3.3 | 3.8 | 4.8 |
| Business sector | 5.4 | 3.4 | 3.3 | 4.1 | 4.8 |
| Non-business sector | 9.7 | 2.8 | 3.7 | 2.8 | 4.9 |

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 12 |
|---|---|---|---|---|---|
| Registered job applicants (thousands) | 542.4 | 541.7 | 510.4 | 448.5 | 354.9 |
| Unemployment rate (percentages) 1) | — | 9.5 | 8.9 | 7.7 | 6.0 |

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

Source: CZSO

**Table 22**

**PRODUCER PRICES**

percentage changes

| | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|
| **Industrial producer prices** | | | | | |
| a) previous period = 100 | 0.1 | 0.6 | 0.0 | 0.2 | 0.4 |
| b) same period of previous year = 100 | -0.3 | 5.7 | 3.0 | 1.6 | 4.1 |
| c) average for 2005 = 100 | -8.2 | -3.0 | 0.0 | 1.5 | 5.7 |
| **Construction work prices** | | | | | |
| a) previous period = 100 | 0.2 | 0.4 | 0.2 | 0.3 | 0.4 |
| b) same period of previous year = 100 | 2.2 | 3.7 | 3.0 | 2.9 | 3.9 |
| c) average for 2005 = 100 | -6.1 | -2.6 | 0.2 | 3.1 | 7.1 |
| **Agricultural producer prices** | | | | | |
| a) previous period = 100 | 0.6 | 0.2 | -0.4 | 0.7 | 2.0 |
| b) same period of previous year = 100 | -2.9 | 8.1 | -9.2 | 1.1 | 16.5 |
| c) average for 2005 = 100 | 2.1 | 10.4 | 0.0 | 1.1 | 18.1 |
| **Market services prices** | | | | | |
| a) previous period = 100 | 0.0 | 0.2 | 0.1 | 0.3 | 0.1 |
| b) same period of previous year = 100 | 1.6 | 2.3 | 1.9 | 3.3 | 1.6 |
| c) average of 2005 = 100 | -1.9 | 0.4 | 0.0 | 3.3 | 5.0 |

Source: CZSO

# LIST OF STATISTICAL TABLES

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