

# INFLATION REPORT / I

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# INFLATION REPORT / I

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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.

The forecast for inflation at the "monetary policy horizon" (about 12–18 months ahead) is of greatest relevance to the decision-making on the current interest rate settings. Section II of the Inflation Report 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. Starting with this Inflation Report, the CNB starts to publish its numerical forecast for the koruna-euro exchange rate in the form of a fan chart similar to the ones it has published for headline inflation, monetary-policy relevant inflation, interest rates and GDP growth since 2008.

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 correspond to the message of the forecast. Information on the Bank Board's discussions at the past two meetings 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 yet and therefore should not attempt to enter the ERM II during 2009. 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 16 December 2008.

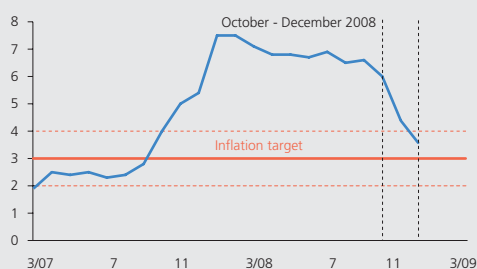
This Inflation Report was approved by the CNB Bank Board on 12 February 2009 and contains the information available as of 23 January 2009.

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.



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**CHART I.1 FULFILMENT OF THE INFLATION TARGET**  
Inflation fell in 2008 Q4 and was back inside the inflation-target tolerance band in December  
(annual percentage changes)



Annual inflation declined sharply in 2008 Q4 and returned to the inflation-target tolerance band for the first time in thirteen months (see Chart I.1). The gradual fall in economic growth continued into 2008 Q3. The current indicators, however, point to a significant economic downswing in Q4 as a result of the global financial and economic crisis. The Bank Board lowered monetary policy rates in two steps by a total of 1.25 percentage points in Q4. The current forecast assumes a sharp slowdown in economic growth due to the global financial and economic crisis. Inflation will decline towards zero in the middle of this year and then start to return to the 2% inflation target. Consistent with the forecast is a decline in market interest rates. At its meeting in February the Bank Board assessed the risks of the forecast as pronounced and decided by a majority of votes to lower the monetary policy interest rates by 0.50 percentage point.

The monetary policy decision-making of the CNB Bank Board in 2008 Q4 was based on the inflation forecast published in the previous Inflation Report. At the monetary policy horizon, both headline and monetary-policy relevant inflation should, according to the forecast, hit the CNB's 2% inflation target valid from 2010. Consistent with the macroeconomic forecast and its assumptions was a decline in interest rates followed a modest rise in late 2009/early 2010.

**TABLE I.1 KEY MACROECONOMIC INDICATORS**  
The koruna-euro exchange rate weakened in 2008 Q4  
(annual percentage changes unless otherwise indicated)

|                                                 | 9/08  | 10/08 | 11/08 | 12/08 |
|-------------------------------------------------|-------|-------|-------|-------|
| Consumer price inflation                        | 6.6   | 6.0   | 4.4   | 3.6   |
| Industrial producer price inflation             | 5.5   | 3.9   | 1.2   | -0.2  |
| Money supply growth (M2)                        | 8.2   | 8.3   | 7.9   | -     |
| 3M PRIBOR <sup>a)</sup> (in per cent)           | 3.8   | 4.2   | 4.2   | 3.9   |
| CZK/EUR exchange rate <sup>b)</sup> (level)     | 24.50 | 24.79 | 25.18 | 26.11 |
| CZK/USD exchange rate <sup>b)</sup> (level)     | 17.05 | 18.58 | 19.77 | 19.48 |
| State budget balance                            |       |       |       |       |
| since January <sup>c)</sup> (CZK bn)            | 10.5  | 10.9  | -6.5  | -19.4 |
| GDP growth at constant prices <sup>d), e)</sup> | 4.2   |       |       | -     |
| Average nominal wage <sup>d)</sup>              | 7.9   |       |       | -     |
| Unemployment rate <sup>e)</sup> (in per cent)   | 5.3   | 5.2   | 5.3   | 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) seasonally adjusted

e) registered unemployment (MLSA); end-of-month position

The Bank Board lowered monetary policy interest rates twice in 2008 Q4 – by 0.75 percentage point with effect from 7 November and by another 0.50 percentage point with effect from 18 December. In both cases, the board members agreed that the balance of risks to inflation was significantly on the downside, or towards a more significant lowering of interest rates. In particular, the outlook for the euro area was deteriorating, interest rates were falling around the world, and prices of commodities, energy-producing materials and food were decreasing sharply. At its December meeting, the Bank Board – aware of the risk of sharp disinflation – added the need to stabilise inflation expectations to the list of arguments for a larger reduction in interest rates.

The November and December cuts in monetary policy interest rates gradually led to a decline in market interest rates at shorter maturities and, to a lesser extent, at longer maturities. Market rates reacted with a sizeable lag, owing to a simultaneous increase in the credit premium resulting from a lack of confidence on the financial markets. The continuing decline in market rates in January this year reflected an expected further lowering of monetary policy interest rates.

Although the interest rate differential shifted to positive values thanks to a larger decrease in foreign than domestic interest rates, the exchange rate of the koruna against both the euro and the dollar depreciated by about 15% compared to early November 2008. The main reason was a decline in non-residents' holdings of domestic portfolio assets. The underlying factor was the liquidity problems faced by many foreign entities due to the deepening of the financial crisis in the USA and Western Europe in September. Demand for koruna instruments was also dampened by worsening sentiment about the Central European region, reflecting the problems of some countries (particularly Hungary and the Baltic States) with external financing and the unfavourable outlook for all economies in the region due to a sharp fall in external demand.

The annual rate of growth of the Czech economy in 2008 Q3 continued to decline gradually. The slower growth showed up in all components of GDP except government consumption. GDP growth continued to be driven by net exports. Household consumption, fixed investment and government consumption also increased. A continuing sharp annual decline in inventories contributed negatively to GDP growth. The available monthly data are signalling a dramatic slowdown in economic growth in 2008 Q4, mainly due to a slump in external demand. Tighter credit conditions and a related decline in lending growth are also having an adverse effect.

In conditions of slowing economic growth, annual employment growth decreased further in 2008 Q3, as did the number of vacancies. This resulted in a turnaround in the unemployment rate at the year-end. The deteriorating labour market conditions did not affect wages significantly in Q3 and annual nominal wage growth in the business sector slowed only slightly compared to the previous quarter. Real wage growth in Q3 continued to be subdued by the persisting high annual inflation.

The decline in prices of food and energy-producing materials, together with declining domestic inflation pressures, led to a sharp slowdown in inflation in 2008 Q4. In December, headline inflation fell below the upper boundary of the inflation-target tolerance band and monetary policy-relevant inflation declined well below the inflation target. Both these indicators were roughly one percentage point lower on average in Q4 than forecasted in the previous Inflation Report. Net inflation declined considerably, and the main contributors to inflation thus were regulated prices and changes to indirect taxes.

Section III of this Inflation Report describes the CNB's latest forecast, which takes into account new information obtained since the previous forecast was drawn up. The current economic situation is still assessed as being a decline from the peak of the business cycle, but the decline is faster than assumed by the previous forecast. Domestic inflationary pressures in the economy are subsiding rapidly. However, the anti-inflationary pressures arising from the strong exchange rate in the first three quarters of 2008 are also fading. Overall, the current inflation pressures are assessed as being anti-inflationary, but their intensity has decreased significantly owing to the weakening exchange rate.

Headline inflation will continue to fall this year and will approach zero in the middle of the year (see Chart I.2). In Q4, however, it will start rising again and approach the 2% inflation target valid from the beginning of 2010. At the monetary policy horizon, i.e. in 2010 H1, headline inflation will be roughly at the inflation target level.

Monetary-policy relevant inflation, i.e. inflation adjusted for the first-round effects of changes to indirect taxes, will differ from headline inflation only in the first half of this year. The forecast for monetary-policy relevant inflation is subsequently identical to that for headline inflation.

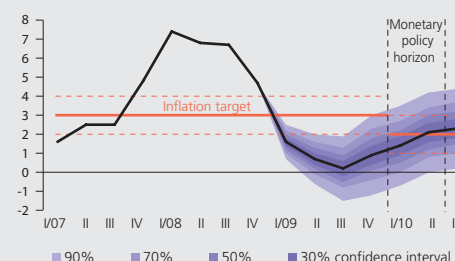
The forecast expects a sharp slowdown in economic growth (see Chart I.3). After recording almost 4% growth in 2008, the Czech economy will slow to roughly zero or slightly negative growth on average this year owing to the global financial and economic crisis. In 2010, in line with a modest recovery of external demand, the forecast expects the economy to return to growth. The growth, however, is expected to be only 1% on average, although it will gradually pick up pace as the year progresses.

Consistent with the macroeconomic forecast and its assumptions is a decline in market interest rates (see Chart I.4). The koruna-euro exchange rate, which is depreciating in 2009 Q1, should correct its losses in Q2 and be broadly flat in the remainder of the forecast period (see Chart I.5).

Starting with this Inflation Report, the CNB is publishing a numerical forecast for the koruna-euro exchange rate in the form of a fan chart similar to the ones it has published for headline inflation, monetary-policy relevant inflation, interest rates and GDP growth since 2008. Box 1 explains the reasons for this step, pointing out the conditional nature of the exchange rate forecast and briefly recapitulating the methodology used to construct the fan charts.

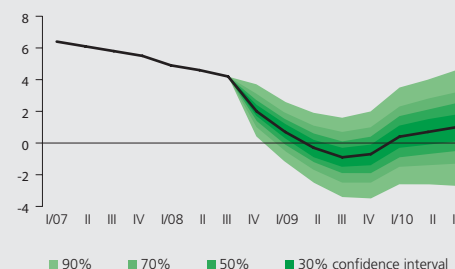
**CHART I.2 THE HEADLINE INFLATION FORECAST**

**At the monetary policy horizon, the headline inflation forecast hits the 2% inflation target valid from 2010**  
(annual percentage changes)



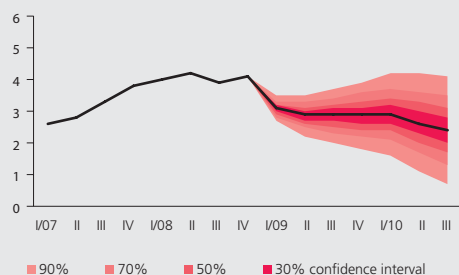
**CHART I.3 THE GDP GROWTH FORECAST**

**A slight decline in economic activity will occur in 2009**  
(annual percentage changes; seasonally adjusted)

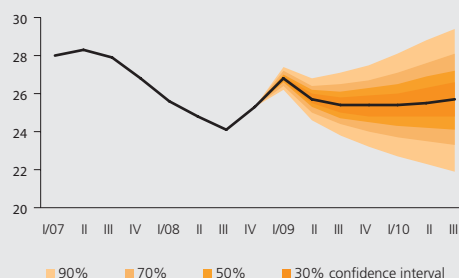




**CHART I.4 THE INTEREST RATE FORECAST**  
 Consistent with the forecast is a decline in market interest rates  
 (3M PRIBOR, %)



**CHART I.5 THE EXCHANGE RATE FORECAST**  
 The nominal exchange rate will initially correct its depreciation observed at the beginning of 2009 and will then be broadly stable  
 (CZK/EUR)



At its meeting in February, the Bank Board assessed the risks of the forecast as pronounced. According to the Bank Board, the further depreciation of the koruna exchange rate can be the upside risk for inflation, while a deeper, long-running downswing in economic activity can be anti-inflationary. In line with the forecast, the Bank Board decided by a majority of votes cast to lower the monetary policy interest rates by 0.50 percentage point. Four members of the Bank Board voted in favour of this decision, one member voted for lowering the repo rate by 0.25 percentage point and one by 0.75 percentage point.

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 16 December 2008. The aim of the document is to inform the Government every year about the current and expected fulfilment of the Maastricht criteria and the degree of alignment of the Czech economy with the euro area economy. The latest assessment resulted in a recommendation not to set a target date for euro area entry yet and therefore not to attempt to enter the ERM II during 2009.

#### BOX 1

##### Publication of a numerical exchange rate forecast

Starting from the first forecast in 2009, the CNB will publish a numerical forecast for the koruna-euro exchange rate in the form of a fan chart. This box explains the reasons for this step, pointing out the conditional nature of the exchange rate forecast and briefly recapitulating the methodology used to construct the fan charts.

Up to now, the exchange rate forecast has been presented in the Inflation Reports by verbal description only, as was the case with the interest rate forecast until the start of 2008. The positive experience with the publication of a numerical interest rate forecast in the form of fan charts led to a decision to publish the exchange rate forecast in the same form. Publication of the exchange rate forecast will thus allow users of CNB forecasts to obtain complete information about the expected evolution of domestic economic variables, to assess the internal consistency of the entire macroeconomic outlook and to get a picture of the balance of risks associated with this forecast with regard to the exchange rate. This step will make the CNB the only central bank in the world to publish a forecast for a nominal exchange rate vis-à-vis a specific currency (although a handful of the most advanced inflation-targeting central banks do currently publish effective exchange rate forecasts). The CNB will thus maximize its communication openness and monetary policy transparency.

However, as emphasised in the case of the interest rate forecast, it is vital that all users of CNB forecasts are aware that the published exchange rate forecast is conditional on assumptions and should in no way be interpreted as a commitment of the central bank to affect the exchange rate or as the exchange rate trend that it prefers. The exchange rate outlook must be understood as a description of the most likely evolution of the exchange rate going forward subject to the assumptions of the CNB macroeconomic forecast and the information available at the time it was drawn up. New information that comes in after the forecast is drawn up can change

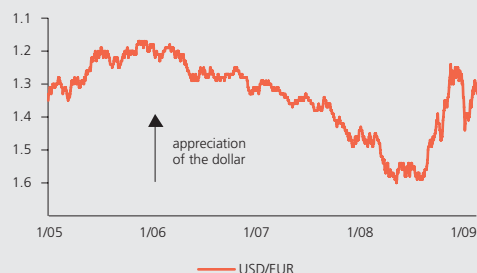
the exchange rate outlook. This includes movements in domestic interest rates that differ from the forecast, for example based on how the Bank Board assesses the balance of risks associated with this forecast. What is more, the exchange rate is subject to significant deviations, more so than the other forecasted variables, so its values can differ significantly from the forecasted ones.

Since 2008, the CNB has been using fan charts to illustrate the general uncertainty of the forecasts published for headline inflation, monetary-policy relevant inflation, the interest rate path and GDP growth. Starting from this Inflation Report, the same will apply to the published exchange rate outlook. The construction and interpretation of fan charts was described in detail in Box 2 of the I/2008 Inflation Report. The central line in the fan chart represents the path of the depicted variable that is consistent with the baseline scenario of the forecast. The bands distributed symmetrically around this central line illustrate the general uncertainty surrounding the forecast. The successively lighter bands represent widening confidence intervals of 30%, 50%, 70% and 90%. The widths of the confidence intervals for each variable are derived from the errors of previous forecasts and are updated annually to coincide with the first Inflation Report of the year.

In addition to the fan charts illustrating the general uncertainty of the forecasts for key variables, including the exchange rate, CNB forecast users can make use of alternative scenarios, minutes of the CNB board meetings or public statements made by its members to assess specific uncertainties, identify the overall balance of risks associated with the forecast and better understand the Bank Board's monetary policy decisions.

**CHART II.1 THE DOLLAR-EURO EXCHANGE RATE**

The exchange rate of the dollar appreciated strongly relative to the previous quarter in 2008 Q4 and January 2009



## II.1 The external environment

The global financial crisis, which erupted in August 2007 and deepened in September 2008, led to a slowdown in GDP growth in all the advanced economies. The outlook for 2008 Q4 and the whole of 2009 is very unfavourable. The crisis also led to a decline in oil prices. The price of Brent crude oil fell from almost USD 143 a barrel in July 2008 to an average of USD 45 a barrel in January 2009. In 2008 Q4 and January 2009, the exchange rate of the dollar fluctuated widely, appreciating by 12% on average compared to Q3. The Central Europe region was also hit by the economic crisis.

Annual economic growth in the USA slowed further in Q3, falling by 1.4 percentage points to 0.7%. Real GDP decreased by 0.5% quarter on quarter in annualised terms, whereas in the previous quarter the economy had grown by 2.8%. This decrease was due to lower household consumption, fixed investment and foreign demand. In addition, the adverse development of numerous indicators (annual declines in retail sales of 9.8% in December and in industrial output of 4.5% in October and 5.5% in November and a very rapid year-on-year increase in the unemployment rate in December of 2.3 percentage points to 7.2%) indicates that the significant fall in annual GDP growth will continue into Q4. In October, the US Congress authorised the Secretary of the Treasury to use USD 700 billion to bail out the embattled US financial system. President Obama is asking Congress for another USD 825 billion for wider use to mitigate the recession.

Inflation in the USA has been declining since July 2008. In December, the consumer price level even dropped by 0.1% year on year (0.7% month on month) following 1% growth in November, mainly because of a decline in energy and transport prices. Industrial producer prices also fell by 1.2% year on year in December, owing primarily to a fall in import prices of energy-producing materials. The negative economic outlook and the rapid decline in inflation led the Fed to further decrease its key interest rates – by 0.5 percentage point to 1% in October and into the range of 0–0.25% in December.

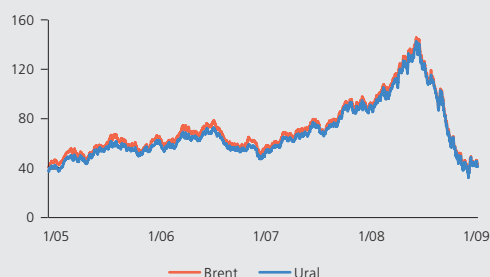
In the euro area, annual GDP growth decreased further to 0.6% in 2008 Q3, from 1.4% in Q2. Consumption growth halted and investment growth slowed sharply. Economic activity shrank by 0.2% quarter on quarter in both Q2 and Q3. The current account deteriorated by EUR 30 billion year on year, mainly because of a worse trade balance. The deepening of the financial crisis in September 2008 led to a further year-on-year decline in both industrial and construction output and a rise in the unemployment rate in October and November. Retail turnover also decreased in October. The business and consumption sentiment indicators worsened considerably. This indicates a further month-on-month and year-on-year decline in GDP in Q2.

Annual HICP inflation in the euro area continued to decline in 2008 Q4, reaching 1.6% in December, owing to falling commodity prices and economic growth. The decline in M3 growth (to 7.8% in November) and in loans to the private sector (8.2%) continued as well. Since October last year, the ECB has lowered its key rate by a total of 2.25 percentage points to 2% in four steps. The most recent change, of 0.5 percentage point, was made on 15 January owing to rapidly declining annual inflation, expectations of a further decline and a forecast of negative GDP growth this year. ECB President Jean-Claude Trichet did not rule out reducing interest rates below their current historical lows. In addition, the gap between the lending rate and the deposit rate was widened back to 2 percentage points on 21 January.

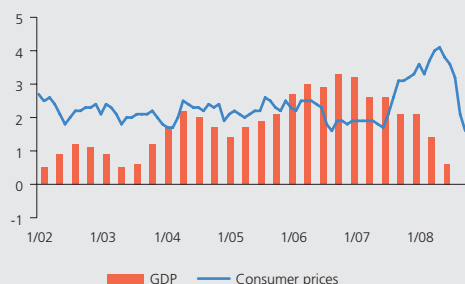
The annual rate of growth of the German economy slowed further in 2008 Q3, to 0.8% from 1.4% in the previous quarter, with growth in German exports and investment falling because of the global economic downswing. In 2008 Q3, the emerging

**CHART II.2 BRENT AND URAL CRUDE OIL PRICES**

The price of crude Brent oil continued to fall sharply in 2008 Q4 and January 2009 (USD/barrel)

**CHART II.3 GDP AND INFLATION IN THE EURO AREA**

In the euro area, GDP growth slowed further in 2008 Q3 and inflation declined in Q4 (annual percentage changes)



crisis had yet to impact fully on the German labour market, and employment was still increasing and unemployment decreasing. In Q4, the real economy was strongly affected by falling external demand. Industrial and construction output decreased both year on year and month on month, and unemployment increased in December. Surveys of business and consumer confidence worsened sharply. In response to the rapid fall in economic activity, the federal government adopted a series of support measures totalling EUR 50 billion. Owing to falling commodity prices and slowing economic growth, German inflation fell back from its peak of 3.3% in July to 1.1% in December.

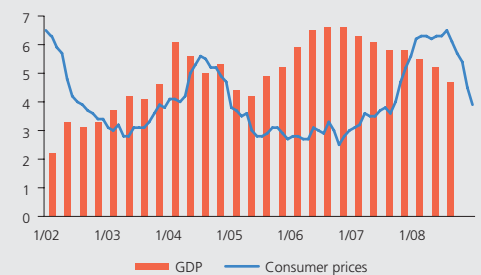
The Central European region was also hit by the economic crisis. Economic growth slackened in all the countries of the region. Their exchange rates (except for the Slovak koruna) depreciated against the euro owing to the worse economic outlook and increasing risk aversion on the major financial markets.

The annual growth of the Polish economy slowed slightly in 2008 Q3, by 0.2 percentage point to 5.8%. Investment growth and export growth declined (to 6% and 7% respectively), but year-on-year employment growth reached 4.4% and the unemployment rate fell. It is clear that the crisis had yet to hit the Polish economy fully in this period. However, the number of signals of slowing economic growth increased in Q4. Unemployment increased by 0.4 percentage point in December as compared to November, reaching 6.9%, and industrial output decreased year on year in both October and November. Growth in retail turnover remained strong, however, thanks to large year-on-year increases in wages and employment. Annual growth in consumer prices slowed in Q4, falling to 3.3% in December. The NBP cut its key interest rate twice in Q4 (in November and December) by a total of 1 percentage point to 5%, owing to the deteriorating outlook for the Polish economy and declining inflation.

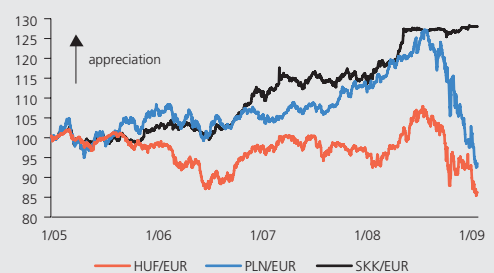
GDP growth in Hungary slowed by 0.6 percentage point to 1% in 2008 Q3. Export growth – previously the main source of growth of the Hungarian economy – dropped to 3.9% from 9.3% in the previous quarter. Industrial and construction output and retail trade turnover all fell year on year in Q4. Declining prices of fuels, food and services led to a fall in headline and core inflation in Q4. HICP inflation fell to 3.4% in December from 5.1% in October. The global financial crisis caused a massive outflow of capital from Hungary in October, leading to a sharp depreciation of the Hungarian forint and destabilisation of the financial system. In late October, the MNB was forced to hike its key rate from 8.5% to 11.5% and the government requested financial support from the EU and the IMF. These institutions, together with the World Bank, lent Hungary a total of USD 25 billion. The government undertook to adopt fiscal stabilisation measures (including cuts in pension and public wage growth), help the banking sector and implement structural reforms. A declining economic outlook and falling inflation led the MNB to lower its key interest rates from 11.5% to 9.5% between November 2008 and January 2009 in four steps of 0.5 percentage point.

Economic growth in Slovakia slowed by 1 percentage point in 2008 Q3 compared to the previous period to 7.6%, but remained the highest in the EU behind Romania. The slowdown was caused by declining growth of all components of aggregate demand except household consumption, whose growth accelerated slightly owing to rises in employment (of 4.5% year on year) and real wages (of 3.5%). A further fall in economic growth in Q4 is indicated by a year-on-year decline in industrial output, slowing retail turnover growth and a year-on-year rise in the unemployment rate in December. Surveys of business and consumer confidence also worsened. Thanks to commodity and food prices, HICP inflation gradually slowed, reaching 3.5% in December. The NBS cut its key rate in three steps by a total of 1.75 percentage points in Q4, each time in line with the ECB. On 1 January 2009, Slovakia joined the euro area.

**CHART II.4 GDP AND INFLATION IN THE NEW EU MEMBER STATES**  
In the "new" EU Member States as well, GDP growth slowed further in 2008 Q3 and inflation declined in Q4  
(annual percentage changes)



**CHART II.5 CENTRAL EUROPEAN CURRENCIES**  
The Hungarian forint and the Polish zloty weakened markedly in 2008 Q4 and January 2009  
(average for January 2005 = 100)



## II.2 THE MONETARY CONDITIONS

Both the interest rate and exchange rate components of the monetary conditions changed quite considerably in 2008 Q4 owing to the global financial crisis. After rising in October, interest rates fell rapidly, and the exchange rate gradually depreciated.

### II.2.1 Interest rates

Financial market interest rates were still rising during October, affected by the global financial crisis. Besides a rising credit premium, the domestic money market recorded a sizeable decrease in liquidity and a widening bid-offer spread on the interbank market. In an effort to support liquidity in the interbank market, the CNB introduced liquidity-providing operations.<sup>1</sup>

A downward trend started after the CNB lowered its key rates by 0.75 percentage point in early November. The rate cut had been expected, but its magnitude took the financial market by surprise. Market rates started to decline gradually on concerns of a substantial slowdown in economic growth and expectations of a further decrease in the CNB's key rates. However, the decline was steady rather than sudden, with different dynamics at different maturities. FRA and IRS derivative rates showed high volatility.

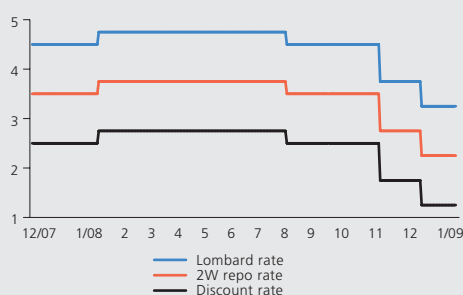
The decline in interest rates continued after a further reduction in the CNB's key rates by 0.50 percentage point in mid-December. With effect from 18 December 2008, the 2W repo rate was set at 2.25%, the Lombard rate at 3.25% and the discount rate at 1.25%. Compared to the beginning of October, PRIBOR interest rates declined by 0.9–1.2 percentage points, FRA rates by 1.5–1.6 percentage points and IRS rates by 0.7–1.4 percentage points depending on maturity. Given the continuing worsening outlook for the domestic economy, most financial market participants were expecting further cuts in key rates by the CNB at the end of January.

The PRIBOR yield curve shifted upwards and steepened slightly at the start of 2008 Q4. After the CNB lowered its key rates in early November, the yield curve started falling and its slope became more positive. The spread between the 1Y PRIBOR and the 2W PRIBOR was 1.27 percentage point in December. The decline in the money market yield curve continued into January and its slope started decreasing as well. The IRS yield curve decreased almost constantly in the period under review, showing a more even decline across the individual maturities than on the money market. The average 5Y-1Y spread was -0.18 percentage point and the 10Y-1Y spread 0.20 percentage point in December.

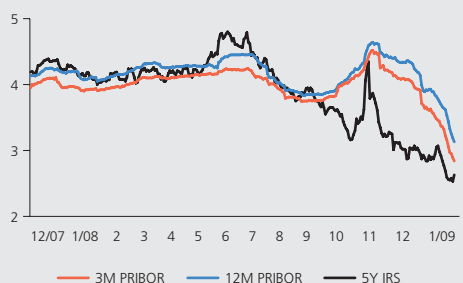
The interest rate differential on the money market (PRIBID/CZK-EURIBOR/EUR or LIBOR/USD) was affected by changes in key rates and by a sharp fall in money market rates. The ECB cut its refinancing rate in four steps by 2.25 percentage points to 2.00%. The Fed lowered its O/N federal funds rate to 0%–0.25%. The interest rate differentials vis-à-vis euro and dollar rates moved into positive values during Q4.

Four auctions were held on the primary government bond market in the period under review, with a variable interest rate and 8Y maturity. The total volume of bonds issued

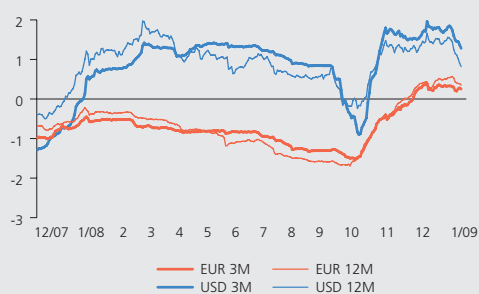
**CHART II.6 THE CNB'S KEY RATES**  
The CNB decreased its key interest rates (percentages)



**CHART II.7 MARKET INTEREST RATES**  
Interest rates quickly fell (percentages)



**CHART II.8 INTEREST RATE DIFFERENTIALS**  
Interest rate differentials moved into positive values (percentage points)



<sup>1</sup> On 15 October 2008, the CNB commenced liquidity-providing repo operations with 2-week maturity. Banks' bids are fully satisfied at a fixed rate equal to the 2W repo rate + 0.1 percentage point. In addition to T-bills and CNB bills, the eligible collateral for these operations includes government bonds, enabling the CNB to ease the tensions on the secondary government bond market (see below). On 26 November 2008, the CNB also introduced liquidity-providing repo operations with 3-month maturity at an interest rate equal to the 2W repo rate + 0.3 percentage point.

amounted to CZK 30.1 billion. The secondary market recorded a marked decrease in liquidity. Trades were executed through brokers only, and market-makers even stopped quoting prices for a time. Standard&Poor's announced that it had affirmed the Czech Republic's foreign currency liabilities rating at A and its local currency rating at A+ with a stable outlook. The current ratings are supported by the country's moderately low external debt and sufficiently competitive economy. Moody's reduced its outlook for the Czech Republic's ratings from positive to stable. However, the agency said that the Czech economy would be more resilient to the global financial crisis than other Central and Eastern European countries.

Nominal interest rates on new loans were 7.1% and rates on new time deposits 2.4% in November. Real interest rates<sup>2</sup> are affected not only by the level of nominal rates, but also by movements in inflation expectations. Consumer price inflation expectations decreased slightly during 2008 Q4, and expected industrial producer price inflation fell too. Real rates on new loans were 4.9% in November, while real rates on time deposits were 0.0%.

## II.2.2 The exchange rate

The average exchange rate of the koruna against the euro was CZK 25.3 in 2008 Q4 (see Chart II.10), which represents a year-on-year appreciation of 5.6%. In quarter-on-quarter terms, however, the koruna weakened by 5.2%. This meant a continuing correction of the previous strong appreciation of the koruna<sup>3</sup>, which had started at the end of July 2008 and lasted about a year. At the end of December 2008, the koruna was just below CZK 27, having lost around 15% compared to its mid-July peak.

The continuing fast depreciation of the koruna-euro exchange rate in 2008 Q4 was accompanied by high volatility, reflecting the considerable uncertainty in global financial markets. Unlike in Q3, when the depreciation had been due mainly to CNB monetary policy and a general rise in short-term investors' interest in dollar assets, the exchange rate was affected in Q4 by factors associated with the onset of the global recession. These included above all a general deterioration of financial market sentiment about the emerging markets and their currencies and investors' inclination towards reserve world currencies (except for the pound). In the Czech Republic it took the form of outflows of foreign portfolio investment. The exchange rate may also have been partly affected by a lower-than-usual supply of foreign exchange on the market from exporting firms as a result of the sharp decline in the export performance of the Czech economy. The koruna-euro exchange rate continued to weaken in January 2009, moving between CZK 27.5 and CZK 27.9 in the middle of the month and still showing high volatility. The January depreciation was also strongly affected by domestic factors as the impacts of the world recession on the Czech economy began to be reflected in the domestic statistics.

In 2008 Q4, the koruna also depreciated against the dollar. For a while, this depreciation was even more pronounced than against the euro, owing to a temporary appreciation of the dollar against most world currencies. The koruna depreciated by 3.9% year on year against the dollar to CZK 19.3 in 2008 Q4. In

CHART II.9 EX ANTE REAL RATES

Ex ante real interest rates on new loans increased (percentages)

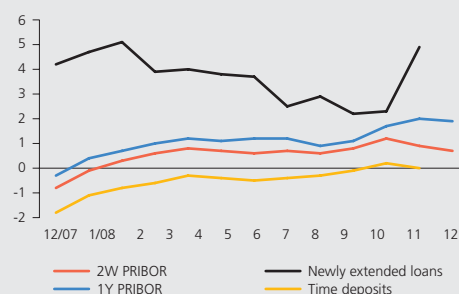
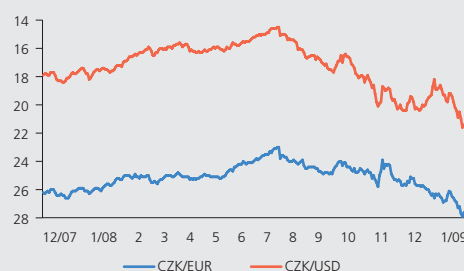


CHART II.10 CZK/EUR AND CZK/USD EXCHANGE RATES

The koruna continued to depreciate against the euro and the dollar in 2008 Q4 and January 2009



<sup>2</sup> Ex ante real interest rates: nominal interest rates on loans are deflated by the industrial producer price inflation forecasted by the CNB; nominal interest rates on deposits and PRIBOR rates are deflated by the consumer price inflation expected by financial market analysts.

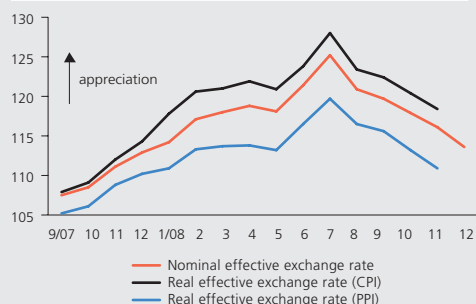
<sup>3</sup> During this period the koruna appreciated by more than 20% against the euro, i.e. by around CZK 5.8.



**CHART II.11 EFFECTIVE EXCHANGE RATES OF THE KORUNA**

The nominal and real effective exchange rates continued to depreciate in 2008 Q4

(year 2005 = 100)



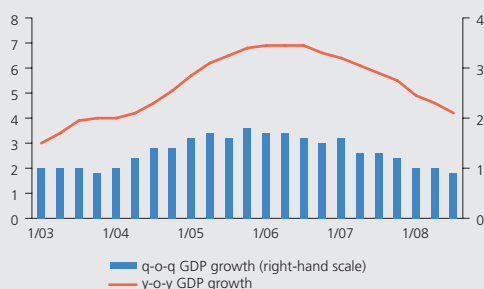
quarter-on-quarter terms, the depreciation reached a record 20% as a result of the combined effect of the dollar's appreciation on world markets and the koruna's depreciation. The koruna continued to depreciate against the dollar in January (reaching CZK 21.3 in mid-January).

The correction of both the nominal and real effective exchange rates of the koruna, which had started in August 2008, continued into Q4 and accelerated significantly compared to the previous quarter (see Chart II.11). The nominal effective exchange rate strengthened by only 4.5% year on year, compared to 15.0% in Q3. At 8.0%, the year-on-year appreciation of the CPI-deflated real effective exchange rate was even more pronounced than that of the nominal rate as a result of higher inflation at home than abroad. By contrast, at 4.3%, the annual appreciation of the PPI-deflated real effective exchange rate was more moderate than that of the nominal rate, owing to slightly higher producer price inflation abroad than in the Czech Republic.

**CHART II.12 GROSS DOMESTIC PRODUCT**

Economic growth slowed further in 2008 Q3

(annual and quarterly percentage changes at constant prices; seasonally adjusted data)



## II.3 DEMAND AND OUTPUT

Economic growth slowed further in 2008 Q3, to 4.2%.<sup>4</sup> The largest contributor to economic growth was foreign trade, even though the rate of growth of its turnover moderated significantly. The economic growth in Q3 was also due to rising final consumption expenditure. Only gross capital formation showed a year-on-year decrease, doing so for the second consecutive quarter. According to the available data, however, the 2008 Q4 developments were very unfavourable.

### II.3.1 Domestic demand

Year-on-year domestic demand growth continued to slow in 2008 Q3. As in the previous quarter, this was chiefly due to gross fixed capital formation, in particular a significant year-on-year fall in investment in inventories. Fixed investment continued rising, albeit at a slower rate than in the previous quarter (4.5%). Annual growth in household final consumption expenditure moderated as well (to 2.5%). Only government final consumption expenditure recorded an annual increase (to 3.7%).

#### Consumer demand

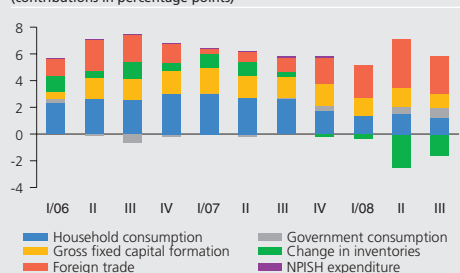
The downswing in household consumption expenditure growth in 2008 Q3 (of 0.7 percentage point to 2.5%) meant a return to the downward trend of previous quarters (see Chart II.14). The none-too-high growth in household consumption expenditure was due mainly to high inflation<sup>5</sup>, which significantly reduced the real purchasing power of households' still rapidly growing nominal income. Consumer confidence of households dropped sharply owing to deteriorating expectations regarding future economic growth and unemployment, falling to a nine-year low according to the latest data for December.

The slowdown in real household consumption expenditure growth in 2008 Q3 was due mostly to a fall in nominal gross disposable income growth (to 8.1%) and, to a lesser extent, to a rise in inflation as measured by the consumption deflator.

**CHART II.13 STRUCTURE OF GDP GROWTH**

Foreign trade was the largest contributor to GDP growth

(contributions in percentage points)



<sup>4</sup> The evolution of GDP expenditure and GDP sources is based on seasonally adjusted data from the CZSO's national accounts.

<sup>5</sup> The household consumption deflator reached 5.8% year on year in 2008 Q3.

However, annual nominal disposable income growth stayed above the 2007 level (with the exception of one quarter). As in previous quarters, the high growth in households' income was driven by growth in wages and salaries (of 6.8%), which accounted for almost half of their current income growth. However, the growth rate of disposable income stayed above the 2007 level mostly because of a marked decline in households' current expenditure growth in 2008 (to 1.8% in Q3). The biggest change was recorded for current income taxes, whose annual decline in the first three quarters of 2008, following a rapid rise in 2007, was connected with the introduction of a flat 15% personal income tax rate.

Disposable income remained the main source of financing of household consumption expenditure. With households' consumption expenditure growing faster than their disposable income, however, there was an annual decrease in gross saving (of 2.8%) and a decline in the saving rate (of 0.9 percentage point to 7.8%) in Q3. Some households also financed their consumption expenditure from credit, but its rate of growth decreased further (for details see section II.6 *Monetary developments*).

The continuing much lower growth in real disposable income than in previous years was accompanied by changes in the consumption behaviour of households in 2008 Q3. These were visible mainly in expenditure on non-durable goods and services, which had recorded sizeable price increases in previous quarters. Chart II.16 shows that in 2008 households' consumption of non-durable goods in the current expenditure items was broadly unchanged and that a downward trend in consumption growth was also apparent in expenditure on services. Households thus channelled their increased expenditure into purchases of semi-durable and durable goods, mainly in the context of rising investment in new dwellings.<sup>6</sup> Looking at the continuing marked deterioration in consumer confidence in Q4, no change in the consumption behaviour of households can be expected in the near future. This is also indicated by the latest October and November data on falling retail sales, particularly in the food segment.

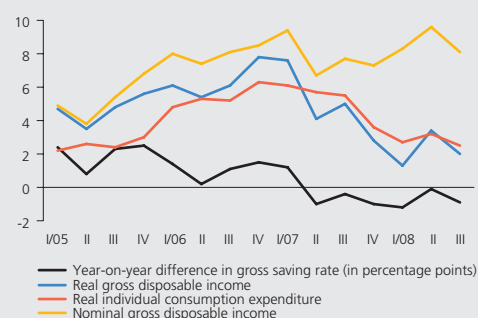
Government consumption increased by 3.7% (7.3% at current prices) year on year in 2008 Q3, chiefly as a result of higher expenditure by health insurance companies, which are part of general government. Total state budget expenditure at current prices increased as well, rising by more than 5% year on year in Q3. Current state budget expenditure grew even faster, mostly due to higher expenditure on non-investment purchases.

In Q4 and in 2008 as a whole, state budget expenditure fell year on year (by 0.8% for the entire year), but this outcome mainly reflected a change in the rules for the operation of unspent budgetary funds in reserve funds. Adjusted for this effect, the government consumption related items saw a more marked increase in public wage expenditure (up by 4.3%) in Q4, but their rise for 2008 as a whole was moderate (1.6%).

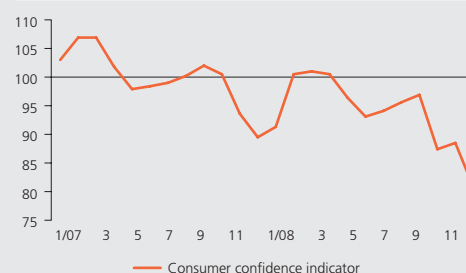
### Investment demand

Investment demand in 2008 Q3 confirmed the trend of declining growth from the high levels reached in 2006 and 2007 (see Chart II.17). In Q3, the moderation in its annual growth (to 4.5%) was now plain to see, and, for the first time since the beginning of 2005, it was accompanied by a quarter-on-quarter decline.

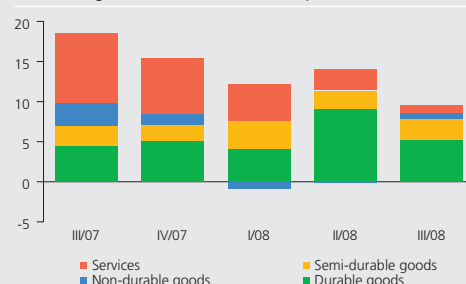
**CHART II.14 HOUSEHOLD CONSUMPTION EXPENDITURE**  
Household consumption growth slowed again in 2008 Q3  
(annual percentage changes)



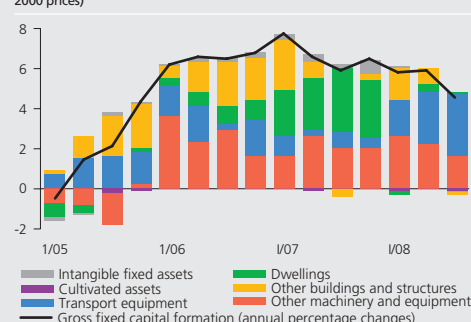
**CHART II.15 CONSUMER CONFIDENCE INDICATOR**  
Consumer confidence continued to drop sharply in 2008 Q3 and Q4  
(2005 average = 100)



**CHART II.16 STRUCTURE OF CONSUMPTION GROWTH**  
Households are gradually reining in their expenditure on services and non-durable goods  
(annual changes in CZK billions; constant 2000 prices)



**CHART II.17 GROSS FIXED CAPITAL FORMATION**  
Growth in investment demand slowed noticeably in 2008 Q3  
(annual percentage changes; contributions in percentage points; constant 2000 prices)



<sup>6</sup> However, annual growth in expenditure on durable goods is slackening as well. It slowed from a high of 24.4% in 2007 Q1 to 10.6% in 2008 Q3.

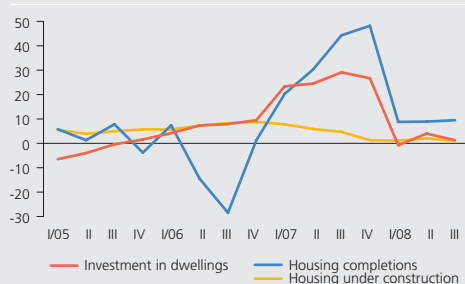


**TABLE II.1 FIXED INVESTMENT BY SECTOR****Most sectors recorded slackening investment activity**

|                                             | I/08 | II/08 | III/08 |
|---------------------------------------------|------|-------|--------|
| Annual percentage changes                   |      |       |        |
| Non-financial corporations                  | 10.8 | 10.0  | 6.4    |
| Households                                  | -2.9 | 3.4   | 3.0    |
| General government                          | 0.0  | -3.6  | 0.7    |
| Financial corporations                      | 21.6 | 15.4  | 2.1    |
| Nonprofit institutions serving households   | -1.2 | -2.1  | -5.8   |
| Share in total fixed investment in per cent |      |       |        |
| Non-financial corporations                  | 60.5 | 60.5  | 59.4   |
| Households                                  | 18.0 | 20.2  | 21.8   |
| General government                          | 19.9 | 17.8  | 17.5   |
| Financial corporations                      | 1.3  | 1.2   | 1.0    |
| Nonprofit institutions serving households   | 0.3  | 0.3   | 0.3    |

**CHART II.18 INVESTMENT IN DWELLINGS****Growth in investment in dwellings was again subdued in 2008 Q3**

(annual percentage changes)

**CHART II.19 NET EXTERNAL DEMAND****Net exports continued to improve significantly in year-on-year terms in 2008 Q3**

(CZK billions; constant 2000 prices; seasonally adjusted data)

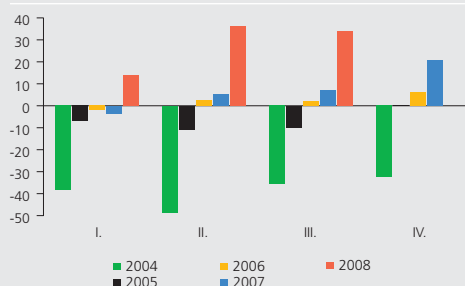


Chart II.17 shows that most of the components of fixed investment contributed to this development. There was a marked decrease in investment in dwellings, and investment in non-residential buildings and machinery was also much lower than in previous quarters. According to revised CZSO data, only investment in transport equipment increased year on year; it has been the biggest contributor to investment growth in the last two quarters.

The main factors behind the downward trend in fixed investment growth include the slowing domestic and external demand, the deteriorating economic growth prospects of the Czech Republic's major trading partners and a deepening fall in corporate profits. These factors were reflected in the investment demand of most of the sectors monitored, especially non-financial corporations and households.

The further slowdown in annual growth in the non-financial corporations sector, which accounts for the largest volumes of investment<sup>7</sup>, was due to lower technological and construction investment. Although their effect was partly offset by a rise in investment in transport equipment, the annual rate of growth of investment by non-financial corporations decreased markedly in Q3 compared to 2008 Q2 (by 3.6 percentage points to 6.4%). The decline in investment activity was visible in most branches of industry. Given the aforementioned adverse factors and tighter lending conditions, the downward tendency in growth in fixed investment by non-financial corporations can be expected to continue.

Even more significant changes were recorded in household investment, which is most affected by investment in dwellings. In 2007 the rate of growth of investment in dwellings had been more than 20%, whereas in 2008 the annual growth average was subdued, reaching only 1.3% according to the latest data for Q3 (see Chart II.18). This sizeable decline in growth was mostly due to base effects, since housing demand had been strongly stimulated in 2007 by an expected increase in VAT on construction work as from 1 January 2008. Investment in dwellings was also partly affected by a more prudent approach of banks to providing mortgage loans and more cautious decision-making by households amid deteriorating prospects for economic growth and unemployment, and by expectations of a more marked price decline in the market for new residential property. Given these facts, it can be judged that the growth rate of investment in dwellings will remain subdued.

Only in the government sector did investment growth rise slightly in 2008 Q3, but this growth was not significant from the point of view of total investment. Rapidly growing civil engineering work on costly transport infrastructure in the last four months suggests, however, a more marked increase in investment financed from public funds in the period ahead.

The year-on-year decline in additions to inventories continued into 2008 Q3. As a result, the contribution of inventories to GDP growth was negative for the fourth consecutive month.

### II.3.2 Net external demand

The overall deterioration in the external conditions due the global financial crisis, together with the record appreciation of the koruna, had a noticeable effect on foreign trade turnover in 2008 Q3. Its slackening, albeit still double-digit, growth seen

<sup>7</sup> The non-financial sector accounts for almost 60% of total investment.

in the previous quarters, decreased significantly to just 3.3% in Q3. The growth rate of exports was almost 9 percentage points lower than in 2008 Q2 (at 5%)<sup>8</sup> and that of imports also decreased significantly (by 8.1 percentage points to 1.6%).

As in previous quarters, the contribution of net exports to GDP was very positive, however, since exports still grew faster than imports. In these circumstances, the year-on-year improvement in net exports continued for the fourth consecutive quarter despite the slackening growth rates of both exports and imports (see Chart II.19).

As in the previous quarter, the year-on-year increase in the net export surplus was due to an improvement in the trade balance, which ended in a high surplus. The services surplus and its contribution to the improvement in net exports were only small in Q3. The year-on-year growth in the net export surplus was affected primarily by an absolute increase in goods exports, which, however, moderated to 4% as a result of a further decline in external demand. This chiefly reflected cooling demand for cars, which reduced the scope for full utilisation of the export potential of new export-oriented capacities. By contrast, growth in exports of services stayed in double figures for the fifth consecutive quarter.

The improvement in net exports in Q3 was also aided by a noticeable slowdown in goods import growth (to 1%), reflecting the high import intensity of exports coupled with the decrease in export growth as well as the continuing weakening of domestic demand. By comparison with the previous year, there was a significant decrease in demand for investment imports as the business and banking sectors became increasingly cautious in their investment decision-making given the slowing economic growth and rising uncertainty regarding future demand.

### II.3.3 Output

On the supply side of the economy, the downward trend in annual gross value added growth observed since mid-2006 continued into 2008 Q3. Compared to 2008 Q2, its growth decreased by another 0.2 percentage point in year-on-year terms (to 4.6%) and moderated slightly further in quarter-on-quarter terms (to 1%).

The evolution of the structure of output and value added indicated ongoing changes in the performance of individual branches. These changes were most evident in manufacturing, where weakening domestic and particularly external demand, as well as the strong exchange rate of the koruna, caused a further decline in year-on-year growth of gross value added in Q3 (of 3.3 percentage points to 2.6%).<sup>9</sup> As a result, the contribution of manufacturing to economic growth fell to less than one-fifth compared to the beginning of 2008, when it reached by far its highest-ever values (see Chart II.21).

Growth in industrial production decreased to 4.7% overall in Q3, although adjusted for seasonal effects the growth was lower at 2.7%. It was again mostly driven by output at new production facilities launched chiefly with the aid of foreign capital, especially in the electrical engineering and transport equipment industries. At the same time, most industries recorded either a continuing slowdown in growth or a decrease in production as observed in previous quarters. The assumption of

**CHART II.20 EXPORTS AND IMPORTS**

**Overall export and import growth slowed significantly in 2008 Q3**

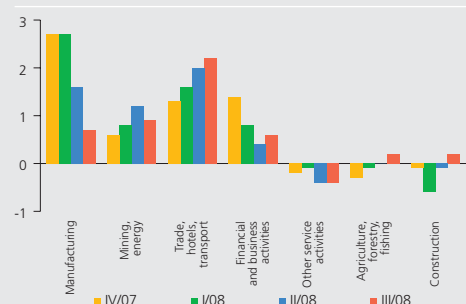
(annual percentage changes; percentage points; constant prices; seasonally adjusted data)



**CHART II.21 CONTRIBUTIONS OF BRANCHES TO GDP GROWTH**

**Market services were the biggest contributor to the growth in value added, while the contribution of industry decreased**

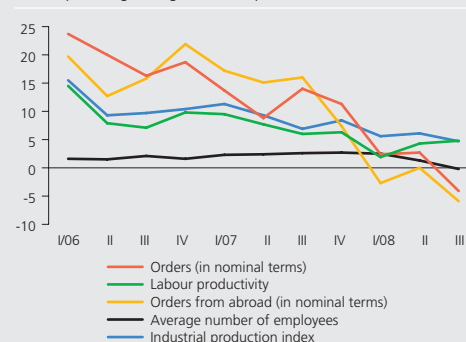
(contributions in percentage points; constant 2000 prices; selected branches)



**CHART II.22 INDICATORS OF DEVELOPMENTS IN INDUSTRY**

**The downward trend in orders in industry indicated weakening domestic and external demand**

(annual percentage changes; constant prices)



<sup>8</sup> The assessment of exports and imports in this section is based on seasonally adjusted data at constant 2000 prices.

<sup>9</sup> In this sector, value added actually decreased slightly in quarter-on-quarter terms (by 0.2%).

a strong effect of the weakening demand on production and value added in industry in Q3 was supported by falling industrial orders in nominal terms (see Chart II.22) and declining production capacity utilisation (see Chart II.23).

The impact of weakening demand was also felt in construction in 2008 Q3. After three quarters of year-on-year decline, gross value added increased (by 4.1% year on year), but the structure of construction output signalled a substantial decrease in building construction work and, on the other hand, an increase in the civil engineering area.

**CHART II.23 PRODUCTION CAPACITY UTILISATION**  
Production capacity utilisation continued to decline  
(full capacity utilisation = 100)

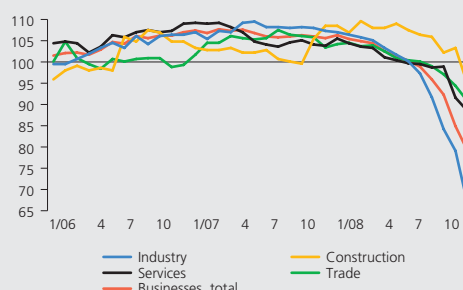


Value added in services in Q3 indicated less sensitivity to the gradual weakening of demand than in industry. As in Q2, this was greatly aided by a continuing buoyant rise in value added growth in trade (to 16.1% in Q3). Value added in other market services categories was already showing slower growth, mainly due to declining activity in the production sector (transport, etc). This trend was also visible in real estate and business services, where value added growth decreased in the first three quarters of 2008 to roughly half its 2007 Q4 level. In the public sector, value added fell year on year in Q3.

According to the latest data for November, the existing adverse trends strengthened significantly in 2008 Q4, particularly in industry and construction. Substantial changes occurred mainly in industrial production, which recorded a sharp annual decline in November (of 16.1%). This was mostly due to export-oriented industries – manufacture of transport equipment, manufacture of basic metals and fabricated metal products, and manufacture of electrical and optical equipment. Output growth was recorded only in the manufacture of coke and refined petroleum products, although it was strongly affected by base effects. The marked fall in industrial production was accompanied by a decline in the number of employed persons of 3.5% and a decrease in new orders of 30.2% (or 33.8% in the case of new orders from abroad). Construction output also saw an annual decrease in Q4 (down by 2.2% in November), with building construction showing a continuing decline.

These developments are consistent with the results of the latest CZSO survey conducted in December, which signals that business confidence in industry, trade and services is continuing to decline markedly (see Chart II.24). The confidence indicator in construction, which had still been relatively high at the end of 2008 Q3, also recorded a sharp fall in the three subsequent months. The main cause of the continuing downward trend in confidence indicators across all the monitored sectors remains the deteriorating demand outlook and the worsening economic situation.

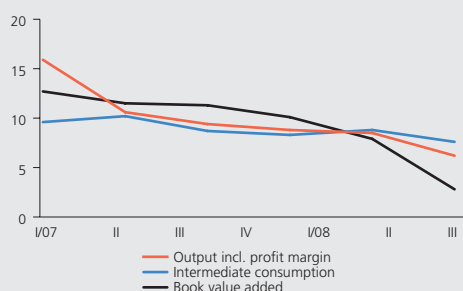
**CHART II.24 CONFIDENCE INDICATORS**  
Confidence continued to decline sharply in all monitored sectors  
(2005 average = 100)



### II.3.4 Financial performance of non-financial corporations<sup>10</sup>

According to the available data and CNB calculations, the developments in 2008 Q3 confirmed a continuing deterioration in the performance of non-financial corporations. Annual growth in output at current prices slowed further, to 5.4%. As in previous quarters, this slowdown was not accompanied by a corresponding moderation of growth in intermediate consumption. Continuing faster growth in the main cost items compared to output contributed to a further decline in the annual rate of growth of book value added to 1.1% (see Chart II.25). Book value added grew by only 3.7% year on year in 2008 Q1–Q3, whereas in the same period of 2007 it had risen by 11.8%. On the basis of the available data it can be estimated that the year-on-year decline in gross operating surplus recorded a significant deepening in 2008 Q3 compared to Q2.

**CHART II.25 KEY FINANCIAL INDICATORS**  
Growth in book value added continued to decline in 2008 Q3  
(annual percentage changes)



<sup>10</sup> The assessment in this section (except in the last paragraph) 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. The last paragraph assesses a set of corporations with 250 employees or more. The data are at current prices.

In 2008 Q3, as in Q2, profit generation was significantly affected by rapid growth in the prices of imported and domestic energy inputs. Continued strong annual growth in the prices of crude oil, natural gas, coal and electricity continued to drive up producer costs. Continuing fast growth in the prices of non-energy-producing commodities was also reflected in producer costs in some branches. By contrast, falling prices of imported intermediate goods fostered cost reductions. According to the CNB's calculations, the combination of these conflicting factors resulted in larger growth in the material cost-output ratio in Q3 than in Q2 (by 1.2 percentage points year on year; see Table II.2).

By contrast, year-on-year growth in the personnel cost-output ratio continued to ease slightly in 2008 Q3, reaching 0.6 percentage point. This change was linked mainly with a slowdown in personnel cost growth (to a still high 10.2%). Nonetheless, the ratio of personnel costs to value added again showed relatively marked growth, albeit less so than in the previous quarter (of 4.6 percentage points year on year).

The financial indicators of large corporations in 2008 Q3 indicated the continuation of some changes in the financial position of corporations from the previous quarter. Overall, however, these did not exceed the risk thresholds of the indicators monitored. Amid year-on-year growth in corporate assets and liabilities (of 7.5%) and equity (of 5.7%), the gross debt<sup>11</sup> of these corporations increased again (by 10.8%) in year-on-year terms as at the end of 2008 Q3. However, its rate of growth was lower than in the previous quarter and it was still below the risk threshold (25.9% of equity). The liabilities structure continued to show mixed trends, with high growth in short-term liabilities (of 15.4%) accompanied by significantly slower growth in long-term liabilities (of 7.3%). The liquidity<sup>12</sup> of the corporations under review continued to fall significantly year on year (by 15.8 percentage points), but was higher than in the previous quarter (138.1%). The solvency<sup>13</sup> of the monitored set of corporations rose slightly above 100%. The asset turnover ratio (sales to total assets) remained largely unchanged. Financial leverage, expressing the ratio of total assets to equity, increased slightly in year-on-year terms.

## II.4 THE LABOUR MARKET

Although the slowing economic growth was still accompanied by rising employment in 2008 Q3, many labour market indicators were signalling a shift to a downward phase of the business cycle. The number of vacancies decreased. The number of unemployed persons was already starting to increase at the end of 2008. The labour shortages visible in the previous quarters subsided. Inflow of labour from abroad moderated in 2008 H2. Although wage growth and nominal unit wage cost growth eased, they remained high, signalling persisting inflationary pressures stemming from wages.

### II.4.1 Employment and unemployment

The slowdown in annual employment growth continued for the third consecutive quarter in 2008 Q3 (see Chart II.26). According to the LFS, annual employment growth, at 1.8%, was 0.3 percentage point lower than in 2008 Q2. The gradual change in the employment trend was linked with adjustment to the slowing growth in domestic and external demand.

**TABLE II.2 PERFORMANCE INDICATORS**

**The material cost-output and personnel cost-output ratios increased in 2008 Q3**

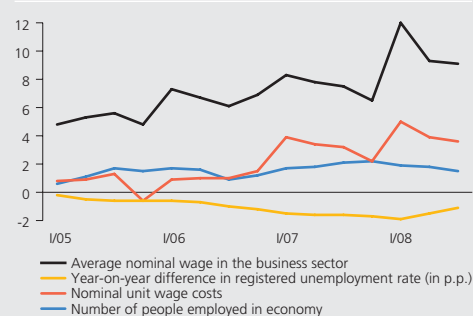
(percentages; CZK billions; annual changes in percentage points and percentages)

|                                                         | 2008 Q3     | 2007 Q3     | Annual percentage changes |
|---------------------------------------------------------|-------------|-------------|---------------------------|
| Output incl. profit margin (CZK billions) <sup>a)</sup> | 1308.5      | 1241.2      | 5.4                       |
| Personnel costs (CZK billions) <sup>a)</sup>            | 200.4       | 181.8       | 10.2                      |
| Intermediate consumption (CZK billions)                 | 950.8       | 887.5       | 7.1                       |
| Book value added (CZK billions)                         | 357.7       | 353.7       | 1.1                       |
| Sales (CZK billions)                                    | 1710.1      | 1616.7      | 5.8                       |
|                                                         | percentages | percentages | Annual changes in p.p.    |
| Personnel costs per book value                          | 56.0        | 51.4        | 4.6                       |
| Material cost-output ratio <sup>a)</sup>                | 72.7        | 71.5        | 1.2                       |
| Personnel cost-output ratio <sup>a)</sup>               | 15.3        | 14.7        | 0.6                       |
| Ratio of book value added to output <sup>a)</sup>       | 27.3        | 28.5        | -1.2                      |

a) CNB calculation

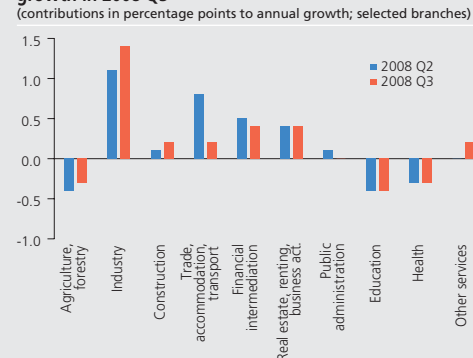
**CHART II.26 LABOUR MARKET INDICATORS**

**Employment growth continued to slow slightly in 2008 Q3**  
(annual percentage changes; percentage points)



**CHART II.27 EMPLOYMENT BREAKDOWN BY BRANCHES**

**Industry was the biggest contributor to employment growth in 2008 Q3**  
(contributions in percentage points to annual growth; selected branches)



<sup>11</sup> Loans received, bonds issued, derivatives on the liabilities side.

<sup>12</sup> The ratio of short-term financial assets to short-term liabilities.

<sup>13</sup> The ratio of financial assets to financial liabilities.

Employment in industry rose by 3.5% in 2008 Q3.<sup>14</sup> It again increased most in manufacturing (by 42,700 people, or 3%, year on year), owing primarily to foreign direct investment and the expansion of activities in related branches. The numbers of employed people rose mainly in branches whose production is largely exported. However, the overall rate of growth of employment in manufacturing in Q3 was lower than in the previous two quarters. Within industry, employment continued to rise in the electricity, gas and water supply sector. Employment also increased in construction in Q3.

In the tertiary sector, overall year-on-year growth in employment moderated considerably in 2008 Q3, reaching less than one-third of that in the secondary sector. As in the previous quarters, employment in this sector increased most significantly in market services, which were also the largest contributor to GDP growth within the tertiary sector. By contrast, the number of employees in public services continued to decline.

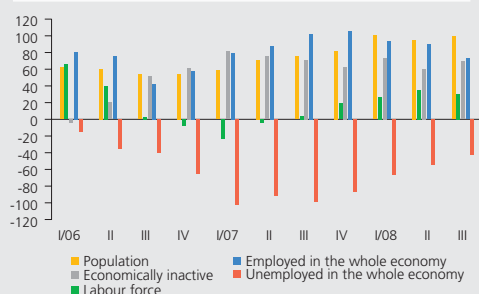
The number of vacancies, which are a potential source of increasing employment, also indicated a changing labour market situation amid slowing economic growth. The continuing decline in the number of vacancies,<sup>15</sup> suggesting lower labour demand, was now being accompanied by a rise in the number of unemployed people in Q3. This trend was even more visible in the final quarter of 2008. It can be inferred from the slope of the Beveridge curve over the last few months that unemployment has been adversely affected by cyclical developments.

The decline in labour demand also started to be reflected more noticeably in the employment of foreign workers, who had helped to overcome labour shortages in some occupations during the boom. A marked slowdown in the growth in the number of foreign workers at the close of 2008 indicates that demand for their labour is already falling. In 2008 H1, annual growth in the number of foreign workers had still exceeded 30%, but by Q4 it had fallen below 25%. This evidence is supported by the results of the CZSO's latest survey, which show that the "barrier to growth" consisting in labour shortages was subsiding and was being replaced by insufficient demand (see Chart II.30).

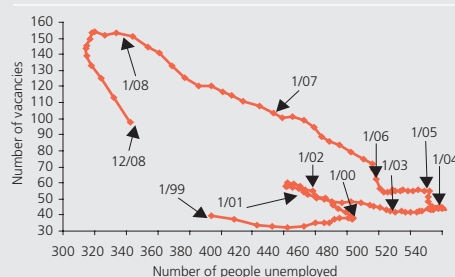
The falling rate of growth of employment was reflected in an increase in the number of unemployed people in 2008 Q3. Adjusted for seasonal effects, however, the number of unemployed people again recorded a slight decline. The general unemployment rate (pertaining to persons aged 15 to 64 years according to the LFS) fell by 0.9 percentage point to 4.3%, the lowest level in twelve years.<sup>16</sup> However, its year-on-year decline is gradually moderating (see Chart II.26) and has virtually come to a halt in quarter-on-quarter terms (see Chart II.31). According to MLSA figures, the registered unemployment rate dropped by 1.1 percentage points year on year to 5.6% in 2008 Q3.<sup>17</sup> This occurred amid a continuing increase in the number of newly registered job applicants, suggesting a shift to a downward phase of the business cycle.

The continuing decline in the number of unemployed people fostered a further annual decline in the number of long-term unemployed people in 2008 Q3

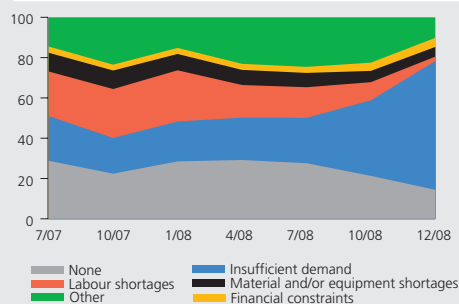
**CHART II.28 LABOUR FORCE FLOWS**  
The annual decline in the number of unemployed people moderated further  
(annual changes in thousands of persons)



**CHART II.29 THE BEVERIDGE CURVE**  
The continuing fall in the number of vacancies started to be reflected in unemployment  
(seasonally adjusted numbers in thousands)



**CHART II.30 BARRIERS TO GROWTH IN INDUSTRY**  
According to the CZSO's survey, the barrier of labour shortages in industry was being replaced by insufficient demand  
(percentages)



<sup>14</sup> According to corporations' reports, by contrast, employment in industry decreased by 0.2%. The difference between these statistics on employment in industry in Q3 may have been caused by different methodologies. The LFS statistics, based on surveys in flats, capture employment of foreigners with difficulty. At times of recession, foreigners are usually laid off first, so the decrease in employment may not have been captured properly by the LFS data.

<sup>15</sup> Seasonally adjusted data.

<sup>16</sup> By international comparison, the general unemployment rate in the Czech Republic is below the average for all the EU Member States and below the euro area average.

<sup>17</sup> The total registered unemployment rate, i.e. including unavailable applicants.



(of 26,400 according to LFS figures). Their share in the labour force diminished further to 2.1%. However, the long-term unemployed still account for almost one-half of all the unemployed. One of the major reasons is their skills structure, which does not match the requirements of the labour market.

The latest partial data on employment suggest that the slowdown in employment growth and the increase in unemployment in 2008 Q4 were more pronounced than in the previous quarters of 2008. According to the latest CZSO sectoral statistics for November, employment is falling particularly noticeably in industry, owing to marked declines in production and orders. According to the latest MLSA data, the registered unemployment rate reached 5.8% in Q4 and recorded a quarter-on-quarter increase in seasonally adjusted terms. This information is in line with the results of the latest survey of confidence in industry for December, which indicated a significant deterioration in the respondents' views of future aggregate and external demand. For similar reasons, employment also fell in construction in Q4.

## II.4.2 Wages and productivity

Following a strong increase at the beginning of 2008, annual growth in the average nominal wage in the economy slowed gradually in Q2 and Q3. In 2008 Q3, it reached 7.9%, only 0.1 percentage point lower than in the previous quarter. As in the previous quarters, average real wage growth was low owing to the high inflation, reaching just 1.2%, its second-lowest level since 1998.

The average wage in the business sector rose by 9.1% in 2008 Q3, representing a slight slowdown compared to the previous quarter. Nevertheless, average wage growth outpaced productivity growth in all the monitored branches. It is likely that average wage growth remained high also as a result of the fading excess demand for skilled labour in some branches. According to MLSA data (AEIS<sup>18</sup>), annual growth in average hourly earnings in the business sector also slowed in Q3 (to 5.1%).

In the non-business sector, average wages again rose considerably slower than in the business sector in Q3. The annual rate of growth of the average nominal wage was 3.7%, which was broadly consistent with the government's plan for wage growth in the state sector. In real terms, the average wage continued to decline (by 2.7% year on year) as a result of the high annual inflation.

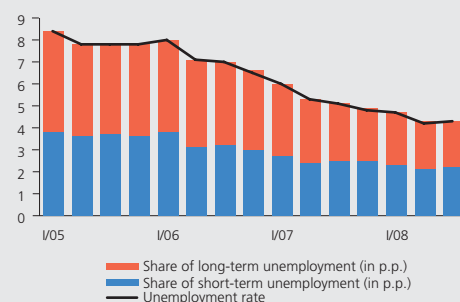
Annual growth in nominal unit wage costs, which are an indicator of potential inflation pressures in the wage area, moderated overall in 2008 Q3. The slowdown in annual nominal unit wage cost growth to 3.6% reflected a decline in annual growth in the volume of wages and salaries at current prices,<sup>19</sup> which was more significant than the decline in the real GDP growth rate. However, growth in nominal unit wage costs was still higher on average than in 2007, as Chart II.33 shows. This was due to the aforementioned faster growth in the average wage compared to productivity growth observed in most monitored branches in 2008, signalling persisting inflationary pressures stemming from wages.

Nominal unit wage costs in industry, which had declined steadily in the previous years, recorded moderate growth for the third consecutive quarter (0.7% in Q3). Productivity growth slowed compared to 2007 and was not accompanied

**CHART II.31 THE UNEMPLOYMENT RATE**

The fall in the unemployment rate halted

(percentages; percentage points; source: LFS)



**TABLE II.3 WAGES, PRODUCTIVITY, UNIT WAGE COSTS**

Average wage growth slowed somewhat but remained high in 2008 Q3

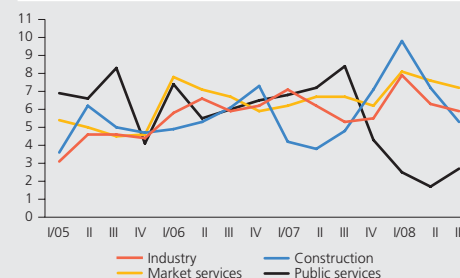
(annual percentage changes)

|                                         | III/07 | IV/07 | I/08 | II/08 | III/08 |
|-----------------------------------------|--------|-------|------|-------|--------|
| Average wage in monitored organisations |        |       |      |       |        |
| nominal                                 | 7.5    | 6.6   | 10.2 | 8.0   | 7.9    |
| real                                    | 4.9    | 1.7   | 2.6  | 1.1   | 1.2    |
| Average wage in business sector         |        |       |      |       |        |
| nominal                                 | 7.5    | 6.5   | 12.0 | 9.3   | 9.1    |
| real                                    | 4.9    | 1.6   | 4.3  | 2.3   | 2.3    |
| Average wage in non-business sector     |        |       |      |       |        |
| nominal                                 | 7.5    | 7.1   | 3.2  | 3.1   | 3.7    |
| real                                    | 4.9    | 2.2   | -3.9 | -3.5  | -2.7   |
| Whole-economy labour productivity       | 3.2    | 3.5   | 2.1  | 2.1   | 2.3    |
| Nominal unit wage costs                 | 3.2    | 2.2   | 5.0  | 3.9   | 3.6    |

**CHART II.32 WAGE DEVELOPMENTS IN BRANCHES**

Most of the monitored branches recorded a slowdown in average wage growth

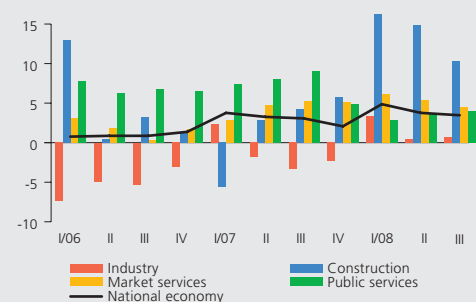
(annual percentage changes; selected branches)



**CHART II.33 NOMINAL UNIT WAGE COSTS**

Nominal unit wage cost growth eased in 2008 Q3 but was still higher on average than in 2007

(annual percentage changes)



18 Average Earnings Information System.

19 The decline in annual growth in the volume of wages and salaries was due chiefly to a slowdown in growth of the number of employed people (0.3 percentage point); the decline in average wage growth was smaller (0.1 percentage point).

by a corresponding change in the average wage. This can be explained, among other things, by corporate decisions on changes in employment amid uncertainty regarding future orders resulting from slowing domestic and external demand. When considering job cuts, corporations take into account the potential future costs of rehiring employees (initial training costs etc.).

In the secondary sector, the personnel cost-output ratio in construction increased, as in the previous quarter. Although wage growth in construction slowed, productivity continued falling. In market services, nominal unit wage cost growth declined from the high levels observed in the previous four quarters, but remained relatively high (4.5% year on year). Productivity growth in this sector picked up pace but remained lower than wage growth. By contrast, nominal unit wage cost growth in non-market services accelerated slightly, as falling productivity was accompanied by faster wage growth.

## II.5 THE BALANCE OF PAYMENTS

*The balance of payments in the first three quarters of 2008 was characterised by a very high income deficit, which deepened further mainly as a result of rapid growth in dividends paid to non-residents, and a persisting high direct investment surplus. At the same time, however, the surplus on the output balance<sup>20</sup> continued rising, driven almost equally by trade and services. The net portfolio investment inflow was due mainly to an issue of government bonds on foreign markets. The deficit on other investment reflected above all a net outflow of long-term capital in commercial banking. A significant unfavourable turnabout in foreign trade occurred in 2008 Q4, owing to a sharp decline in external demand.*

### II.5.1 The current account

In the first three quarters of 2008, the current account ended in a deficit of CZK 60.4 billion (see Table II.4), or 2.2% of GDP. In year-on-year terms, the deficit increased by almost CZK 24 billion. Only two-thirds of the significant year-on-year widening of the income deficit was offset by the favourable results of the remaining three balances.

In 2008 Q1–Q3, the trade balance recorded a surplus of CZK 110.1 billion, up by CZK 16.4 billion on a year earlier (see Chart II.34). Two-thirds of the favourable trend in real terms was offset by unfavourable price developments, manifested in deteriorating terms of trade. Previously, the increasing surplus had been affected chiefly by favourable supply side changes as a result of past FDI inflows, and relatively strong external demand, which, however, weakened gradually during the year. In Q4, however, a significant unfavourable turnabout in foreign trade occurred, owing primarily to a sharp decline in external demand and also because of high oil imports. The trade surplus had still been rising in Q3, but it fell by CZK 25.4 billion year on year in October and November.

As regards the commodity structure, the trade balance again showed very mixed trends in the first three quarters of 2008. Growth in the surplus on machinery, especially monitors and television receivers, made the largest contribution to the increase in the total surplus. By contrast, the largest deterioration was recorded in the deficit on mineral fuels. From the geographical perspective, year-on-year growth in the trade surplus was again visible in trade with EU countries, in particular Germany and the Netherlands. However, the total trade deficit with non-EU countries widened further, chiefly because of an increase in the trade deficits with China and Russia.

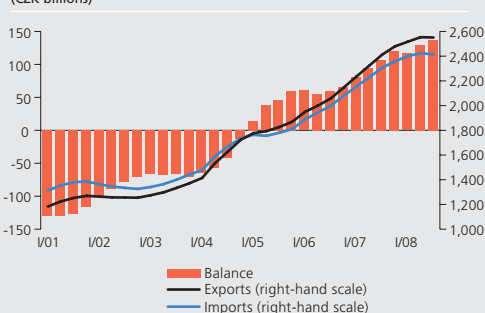
**TABLE II.4 THE BALANCE OF PAYMENTS**

**The current account deficit increased in 2008 Q1–Q3 as a result of growth in the income deficit**  
(CZK billions)

|                                             | I–III/05 | I–III/06 | I–III/07 | I–III/08 |
|---------------------------------------------|----------|----------|----------|----------|
| <b>A. CURRENT ACCOUNT</b>                   | -24.4    | -38.4    | -36.8    | -60.4    |
| Trade balance                               | 52.2     | 52.4     | 93.6     | 110.1    |
| Balance of services                         | 31.8     | 37.5     | 45.8     | 65.6     |
| Income balance                              | -114.8   | -119.5   | -160.4   | -231.9   |
| Current transfers                           | 6.4      | -8.8     | -15.8    | -4.1     |
| <b>B. CAPITAL ACCOUNT</b>                   | 2.5      | 3.0      | 6.2      | 21.6     |
| <b>C. FINANCIAL ACCOUNT</b>                 | 130.5    | 51.2     | 37.5     | 111.9    |
| Direct investment                           | 225.6    | 65.0     | 99.6     | 121.3    |
| Portfolio investment                        | -60.9    | -56.6    | -65.9    | 34.7     |
| Financial derivatives                       | -2.1     | -1.3     | 3.3      | 0.0      |
| Other investment                            | -32.0    | 44.2     | 0.5      | -44.1    |
| <b>D. ERRORS AND OMISSIONS</b>              | -19.0    | -13.7    | -9.3     | -34.8    |
| <b>E. CHANGE IN RESERVES (- = increase)</b> | -89.6    | -2.1     | 2.5      | -38.3    |

**GRAF II.34 THE TRADE BALANCE**

**The annual moving total of the trade surplus increased in 2008 Q3**  
(CZK billions)



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

The balance of services ended 2008 Q1–Q3 in a surplus of CZK 65.6 billion, up by almost CZK 20 billion on a year earlier. This was aided chiefly by a decline in the deficit on other services as a result of very fast growth in credits. The surplus on transport services also increased slightly. By contrast, the surplus on travel decreased slightly owing to strong annual appreciation of the koruna and slowing external demand.

The income deficit reached CZK 231.9 billion, representing a year-on-year deterioration of CZK 71.5 billion (see Chart II.35). The largest and fastest-growing component of the income balance was dividends paid on foreign direct investment to non-residents. The direct investment income deficit thus widened (to CZK 214.8 billion) in year-on-year terms. The other three component balances also deteriorated, albeit to a lesser extent. The surplus on portfolio investment income turned into a deficit as a result of a decrease in credits, owing to faster interest rate cuts abroad than in the Czech Republic and weaker demand for foreign securities. The surplus on other investment income also declined slightly. The deficit on compensation of employees widened as well, owing to further growth in expenditure on foreigners working in the Czech Republic.

Current transfers ended in a total deficit of CZK 4.1 billion as a result of developments in Q3. However, this represented a year-on-year improvement of CZK 11.7 billion. The determining factor of the current transfers deficit was a private transfers deficit exceeding CZK 13 billion. However, its adverse impact was largely offset by a surplus on government transfers, due to very fast growth in credits in H1.

### II.5.2 The capital account

The capital account recorded a surplus of CZK 21.6 billion in the first three quarters of 2008 (a year-on-year increase of CZK 15.4 billion). Its largest component was government revenues from EU funds (CZK 21.5 billion), which tripled in year-on-year terms.

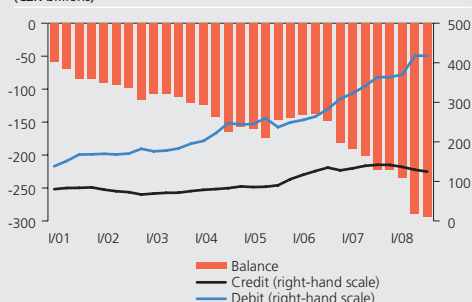
### II.5.3 The financial account

The financial account ended 2008 Q1–Q3 in a surplus of CZK 111.9 billion, or 4.0% of GDP, representing a significant year-on-year increase due to direct and above all portfolio investment. By contrast, a net outflow of other investment had a downward effect on the total surplus.

Direct investment recorded a surplus of CZK 121.3 billion, representing a year-on-year increase of CZK 21.7 billion. The increase was due chiefly to inflows of FDI into the Czech Republic of CZK 138.3 billion. These inflows were related to higher investment in other capital, linked with net borrowing of domestic companies from their foreign parent companies. The largest component was again reinvested earnings (CZK 91.5 billion). Investment in equity capital was around one-third of this figure. With regard to industries, the equity capital inflow was channelled primarily into manufacture of radio, communication and television equipment and manufacture of chemical products (see Chart II.36). By territory, the biggest investor countries were the Netherlands and Cyprus. As a result of lower investment in equity capital, Czech direct investment abroad declined slightly year on year to CZK 17.0 billion.

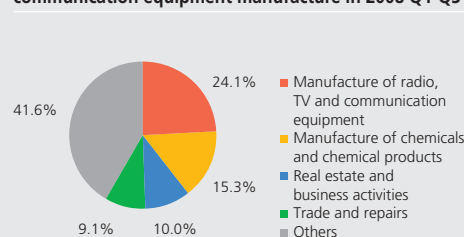
**CHART II.35 THE INCOME BALANCE**

The annual moving total of the income deficit increased further in 2008 Q3



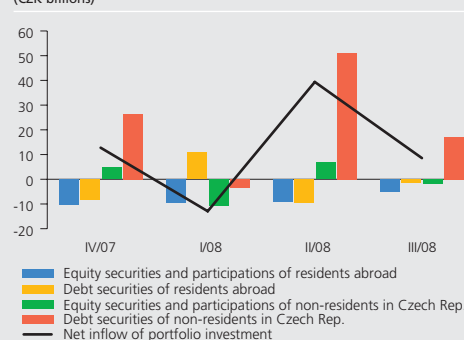
**CHART II.36 FOREIGN DIRECT INVESTMENT**

One fourth of investment in equity capital in the Czech Republic was directed into radio, TV and communication equipment manufacture in 2008 Q1–Q3



**CHART II.37 PORTFOLIO INVESTMENT**

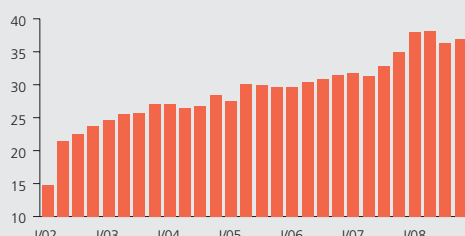
Portfolio investment recorded a net inflow in 2008 Q3





**CHART II.38 THE CNB'S INTERNATIONAL RESERVES**

The CNB's international reserves increased slightly in dollar terms in 2008 Q4  
(USD billions)



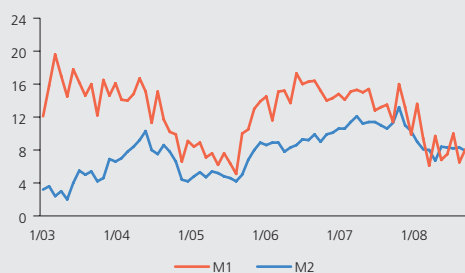
Portfolio investment recorded a net inflow of CZK 34.7 billion in 2008 Q1–Q3 (see Chart II.37). In the same period a year earlier, it had ended in a net outflow of almost CZK 66 billion. The most important operations that led to the overall change in flows were government and corporate bond issues on foreign markets, resulting in a total gross inflow of capital of CZK 58.8 billion. Adjusted for these operations, sales of domestic equity and debt securities by foreign investors exceeded purchases. In Q1–Q3, the outflow of residents' portfolio capital amounted to CZK 24.1 billion. It was associated almost exclusively with purchases of foreign equity securities, which, however, fell by one-half in year-on-year terms as a result of growing expectations of unfavourable economic developments abroad. An only modest increase in holdings of foreign bonds by residents chiefly reflected the rapid decline in foreign interest rates.

Other investment recorded a net outflow of CZK 44.1 billion in 2008 Q1–Q3 (compared to a small net inflow of CZK 0.5 billion in the same period a year earlier). The overall deficit was affected most by a net outflow of commercial banks' capital of CZK 26.6 billion. This was associated with a net outflow of long-term capital as a result of increased investment by domestic financial institutions abroad. A stronger net outflow of capital (CZK 22.4 billion) was also recorded in the corporate sector, due mainly to repayments of trade credits and financial loans, but also to an increase in export credits provided and deposits abroad. On the other hand, a slight net capital inflow into the government sector fostered a moderation of the overall deficit.

The CNB's international reserves rose by CZK 89.6 billion to CZK 715.7 billion in 2008 Q4. This rise was due mostly to valuation changes. In dollar terms, the reserves increased by USD 0.7 billion to USD 37.0 billion at the close of Q4, after having decreased in October (see Chart II.38).

**CHART II.39 M1 AND M2**

M2 growth slowed in 2008  
(annual percentage changes)

**TABLE II.5 MONETARY AGGREGATE STRUCTURE**

The growth rate of currency in circulation increased  
(quarterly averages and end-of-month stocks; annual percentage changes)

|                               | II/08 | III/08 | 10/08 | 11/08 | Share in M2, % 11/08 |
|-------------------------------|-------|--------|-------|-------|----------------------|
| M1                            | 8.4   | 8.1    | 6.5   | 8.1   | 58.1                 |
| Currency in circulation       | 5.5   | 4.6    | 15.1  | 13.9  | 14.3                 |
| Overnight deposits            | 9.2   | 9.2    | 4.0   | 6.4   | 43.8                 |
| M2-M1 (quasi money)           | 6.6   | 8.6    | 10.9  | 7.5   | 41.9                 |
| Deposits with agreed maturity | -2.0  | -0.4   | 2.0   | -4.5  | 25.8                 |
| Deposits redeemable at notice | 24.0  | 27.1   | 29.1  | 32.6  | 15.2                 |
| Repurchase agreements         | 185.1 | 107.4  | 54.1  | 86.5  | 0.9                  |
| M2                            | 7.6   | 8.3    | 8.3   | 7.9   | 100.0                |

## II.6 MONETARY DEVELOPMENTS

The monetary aggregates were affected mainly by the continuing slowdown in economic growth and by the effects of the global financial and economic crisis. The growth rate of currency in circulation increased, lending growth is slowing and non-performing loans are rising especially among non-financial corporations. The rate of change of new loans declined, even falling to negative figures for households. In addition to tighter credit conditions, this trend is due to lower availability of funds in some banks for financing bank loans on the interbank market or from primary deposits.

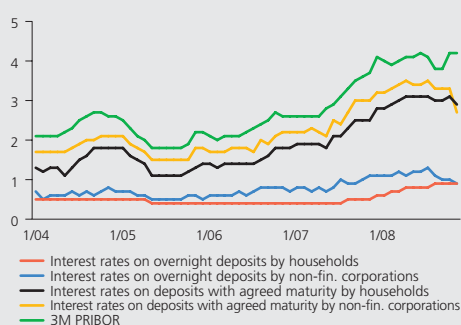
### II.6.1 Money

Annual M2 growth slowed further at the close of 2008, reaching 7.9% in November (see Chart II.39). A decline in money supply growth was recorded for 2008 as a whole, owing chiefly to slowing economic growth, lower domestic loan growth resulting from tightening credit conditions, and marked exchange rate appreciation. Indicators of the appropriateness of the money supply growth suggested a subsiding of the inflationary effect of money in the medium term.

Within the money supply, growth in the transaction money included in M1 eased in October but rebounded in November (see Table II.5). The growth rate of currency in circulation picked up significantly at the expense of overnight deposits. Annual growth in quasi money increased in October but fell back in November, due mainly to deposits with agreed maturity. Household deposits were the biggest contributor to M2 growth. Their rate of increase was 10.2% in November. The rate of growth of deposits by non-

**CHART II.40 INTEREST RATES ON DEPOSITS**

Interest rates on deposits started to fall  
(new business; percentages)



financial corporations fell towards zero and was the main cause of the slowdown in the money supply in 2008. Growth in deposits by non-monetary financial institutions also slowed in 2008, to 3.8% in November.

Interest rates on deposits of households and non-financial corporations declined (see Chart II.40), with the exception of deposits with an agreed maturity of over one year. The increase in the rate on these deposits was probably influenced by banks' efforts to secure funding at a time of interbank market tension. The opportunity costs of holding liquid money, measured by the spreads between the rates on deposits with an agreed maturity of up to one year and the rates on overnight deposits, recorded a decline.

## II.6.2 Credit

Annual growth in MFI loans to corporations and households continued to slow, reaching 18.6% in November 2008 (see Table II.5). This was due mainly to slower economic growth, tighter credit conditions and past interest rate increases. Throughout 2008, the slower growth in loans was due to loans to households and, to a lesser extent, loans to non-financial corporations. The falling loan growth was signalled by newly extended loans even more noticeably than by outstanding amounts (see Chart II.41). This trend in new loans has been recorded for quite some time – since 2007 in the case of households and since early 2008 in the case of non-financial corporations. In Q3, corporations and households also borrowed less from non-bank institutions. The slowdown in economic growth resulted in a higher rate of growth of non-performing loans, especially among non-financial corporations. The negative signals from the real economy may also feed through with a lag to non-performing loans to households. Despite the gradually slowing loan growth, the ratio of loans to GDP increased on average from 47.7% in Q2 to 49.5% in Q3.

The annual growth rate of loans to non-financial corporations continued to fall, confirming the trend recorded throughout 2008. This fall was due mainly to loans provided to developers and the financial intermediation sector. By contrast, the contribution of loans to the manufacturing, energy and trade sectors has increased moderately over recent months. The growth rate of total loans to non-financial corporations was lower than in early 2008 in almost all sectors that had contributed most to the growth in lending in the past. In November, the rate of growth of short-term loans for financing corporations' operating needs declined considerably. By contrast, growth in medium-term and long-term loans picked up pace. Earlier in 2008, however, the opposite had been true, with short-term loans rising the fastest. The slowdown in lending growth was also reflected in slower annual growth in total corporate financing<sup>21</sup> (down to 7% in Q3).

Growth in loans to households also slowed, to 23.9% in November (see Chart II.42). Slower growth was recorded for loans for house purchase and for consumer credit. New loans for house purchase and new consumer credit even recorded year-on-year declines. The slower growth in household borrowing was also related to an expected deterioration in the general economic situation and the financial situation and to a weakening of the housing market. Supply prices of flats rose at a slower pace in 2008 Q4 than in the previous quarter, even recording a decline in Prague. In Q3, total (bank and non-bank) household debt increased to 50.8% of gross disposable income and 26.4% of GDP. The ratio of households' interest expenses edged down to 1.8%.

**TABLE II.6 LOAN STRUCTURE**

**Growth in loans eased further**

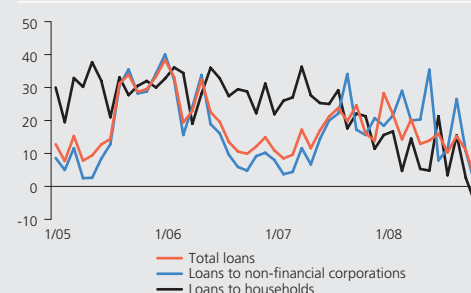
(quarterly averages and end-of-month stocks; annual percentage changes)

|                                     | II/08 | III/08 | 10/08 | 11/08 | Share in total loans in % |
|-------------------------------------|-------|--------|-------|-------|---------------------------|
| Non-financial corporations          | 16.3  | 14.8   | 15.7  | 15.5  | 45.7                      |
| Loans up to 1 year                  | 32.8  | 28.7   | 27.5  | 20.4  | 19.1                      |
| Loans over 1 year and up to 5 years | -5.3  | -4.8   | -1.7  | 7.6   | 9.3                       |
| Loans over 5 years                  | 14.2  | 13.4   | 14.5  | 15.0  | 17.3                      |
| Households                          | 30.7  | 28.0   | 25.7  | 23.9  | 45.8                      |
| Consumer credit                     | 26.4  | 25.3   | 24.6  | 22.9  | 8.9                       |
| Loans for house purchase            | 32.8  | 29.1   | 26.6  | 24.3  | 32.3                      |
| Other loans                         | 25.5  | 25.8   | 21.6  | 23.0  | 4.6                       |
| Non-monetary financial institutions | 37.3  | 28.5   | 13.5  | 9.1   | 8.5                       |
| Total loans                         | 24.3  | 21.7   | 19.9  | 18.6  | 100.0                     |

**CHART II.41 NEWLY EXTENDED LOANS**

**New loans to households decreased**

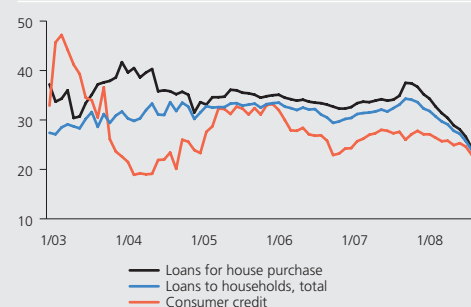
(annual percentage changes)



**CHART II.42 LOANS TO HOUSEHOLDS**

**Loans for house purchase and consumer credit both showed lower growth**

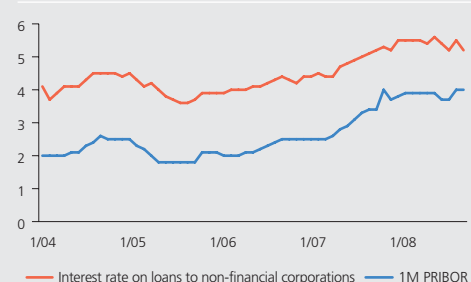
(annual percentage changes)



**CHART II.43 INTEREST RATE ON LOANS TO NON-FINANCIAL CORPORATIONS**

**The interest rate on loans to non-financial corporations fell**

(new business; percentages)

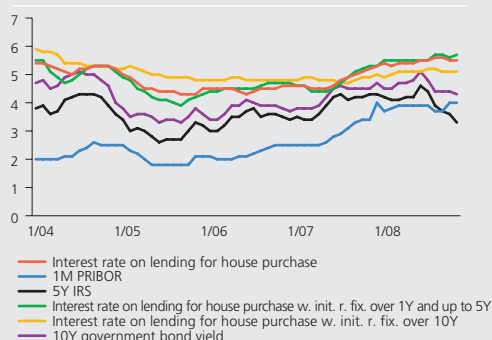


<sup>21</sup> Total financing comprises loans, debt securities, equity and trade credits. Annual growth in corporate financing through loans and securities also slowed in Q3, to 14.1%. The ratio of loans and debt securities to GDP rose to 46.7% in Q3 despite the decline in growth of loans to corporations.

**CHART II.44 INTEREST RATE ON LENDING FOR HOUSE PURCHASE**

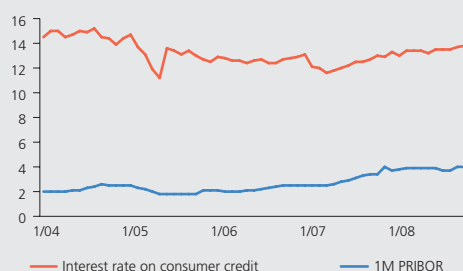
The interest rate on lending for house purchase was flat at short and long maturities

(new business; percentages)

**CHART II.45 INTEREST RATE ON CONSUMER CREDIT**

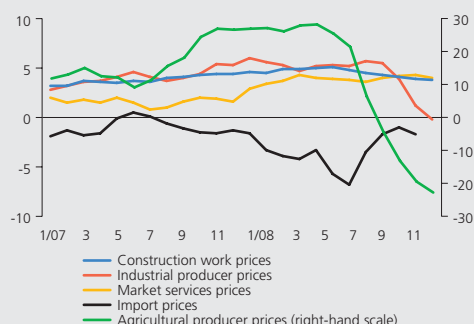
The interest rate on consumer credit continued to rise

(new business; percentages)

**CHART II.46 IMPORT PRICES AND PRODUCER PRICES**

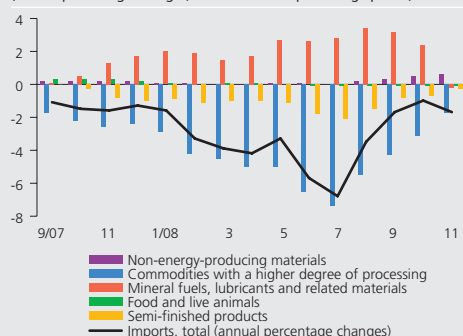
Industrial and agricultural producer prices saw an abrupt change in trend in 2008 Q4

(annual percentage changes)

**CHART II.47 IMPORT PRICES**

The annual decline in import prices continued

(annual percentage changes; contributions in percentage points)



As in the euro area, banks in the Czech Republic are reassessing their risks in the light of the global financial crisis and responding to the worse situation by tightening their lending conditions, especially for households. The impact of the deepening global financial crisis on the economy is thus further increasing the uncertainty surrounding future credit developments.

The average interest rate on new client loans increased in October but fell by 0.1 percentage point to 7.1% in November. It probably reflected banks' initial response to the 75 basis point decrease in the 2W repo rate for some types of loans. Long-term financial market interest rates were falling owing to the worse outlook for the domestic economy. Within client interest rates, the rate on loans to non-financial corporations recorded a decrease (see Chart II.43). The rate on new loans for house purchase was broadly flat and the rate on consumer credit rose (see Chart II.44 and Chart II.45). The spreads between these rates and financial market rates increased above all for new loans to households. In November, they also widened slightly for new small loans to non-financial corporations.

## II.7 IMPORT PRICES AND PRODUCER PRICES

The abrupt turnaround in oil prices on world markets in 2008 Q4 fostered a rapid decline in the annual rate of growth of import prices of energy-producing materials, which even turned negative in November. Falling prices of imported food, semi-finished products and products with a higher degree of processing also had an anti-inflationary effect. However, prices of non-energy-producing materials continued to rise in year-on-year terms. Growth in industrial producer prices eased significantly and even declined in year-on-year terms at the close of 2008. Agricultural producer prices dropped significantly. Price growth in construction slowed. Only prices of market services remained broadly unchanged overall.

### II.7.1 Import prices

Import prices continued to fall year on year in the first two months of 2008 Q4. However, this fall has been moderating since July, reaching 1.7% in November (see Chart II.47). Import prices declined in most import categories. Only prices of non-energy-producing materials showed strong growth. However, their impact on the overall evolution of import prices was insignificant.

As in the previous period, the persisting annual decline in import prices was due chiefly to the exchange rate of the koruna. Since August, however, its year-on-year appreciation has decreased gradually from the high levels observed in the previous quarters. In November, the annual appreciation of the koruna-euro exchange rate fell to 5.8% and that of the koruna-dollar exchange rate recorded an even more marked change, culminating in a year-on-year weakening in November.<sup>22</sup>

These exchange rate movements were most evident in import prices of products with a higher degree of processing, whose price growth abroad is usually moderate and less volatile. The effect of the sharp decline in the annual appreciation of the koruna (with the koruna-euro exchange rate playing a dominant role) on import prices in this category is illustrated in Chart II.48. Import prices also fell in other commodity categories included in the import price index. Amid further declines in

<sup>22</sup> The koruna-dollar exchange rate strengthened by 27.7% year on year in July and 2.9% in October, but weakened by 8.7% in November.

prices of agricultural and food commodities on world markets and the moderating appreciation of the koruna, the year-on-year decrease in food import prices weakened somewhat to 1.2% in November. The exchange rate had a major impact on import prices of semi-finished products, whose annual rate of decrease in November was almost 8 percentage points lower than in July.

Following several quarters of rapid growth, import prices of energy-producing materials also recorded a modest annual decline of 1.5% in November, reflecting the sharp decrease in oil prices on world markets (see Chart II.49). Although the annual growth rate of Brent crude oil prices had started to fall rapidly in July from its peak of around 90% in June, import prices of mineral fuels rose very strongly until October. This seeming inconsistency was due mainly to natural gas prices, which followed oil prices with a longer-than-usual lag. According to the latest CZSO data, world prices of natural gas were still rising at a fast pace of around 70% in November, while world prices of oil fell sharply for the second consecutive month (36.7% in November). The aforementioned slowdown in the year-on-year appreciation of the koruna-dollar exchange rate, which turned into depreciation in November, also acted against any greater moderation of growth in prices of imported energy-producing materials. Import prices of non-energy-producing materials continued to rise rapidly, accelerating to 24.6% in November.

Overall, import prices seemed to have mixed effects on the individual price categories in the first two months of 2008 Q4. Their potential impact on domestic prices was anti-inflationary overall, although the magnitude of this effect was weakened by the continuing slowdown in the year-on-year appreciation of the koruna and the weakening of the koruna against the dollar in November. The renewed decline in import prices of energy-producing materials, which reduced the upward cost pressures on prices in the production sector as well as consumer price inflation, constituted a significant change.

## II.7.2 Producer prices

### Industrial producer prices

The sharp slowdown in industrial producer prices in Q4 and their subsequent annual decline in December 2008 were due mainly to world prices of oil and agricultural and food commodities. High industrial producer price inflation, standing mostly above 5% until September, switched quickly to a decline in Q4 (of 0.2% in December – Chart II.50). Most branches of industry recorded a decline in producer prices in December. Rapid price growth continued only in energy sectors<sup>23</sup> and in industries involved in processing imported non-energy-producing materials, primarily metal-based ones.

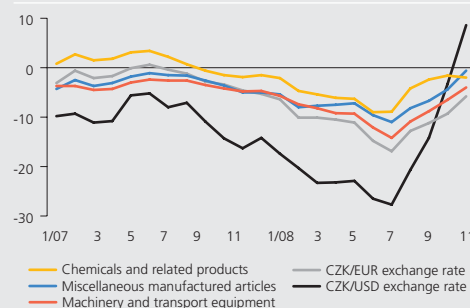
The sharp industrial producer price inflation in 2008 Q4 was due mostly to producer prices in the manufacture of coke and refined petroleum products, which grew by 18% in September but showed an annual decline of more than 30% in December. This was due mainly to the sharply falling prices of oil on world markets (see Chart II.50).

In Q4, producer prices in the food industry followed a similar path as prices in oil processing. The falling annual growth rates from their previously high levels and the subsequent switch to a decline primarily reflected the changing

**CHART II.48 COMMODITIES WITH A HIGHER DEGREE OF PROCESSING**

The koruna exchange rate was a major contributor to the slower fall in import prices of commodities with a higher degree of processing in 2008 H2

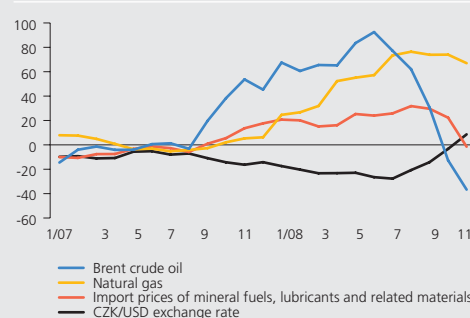
(annual percentage changes)



**CHART II.49 MINERAL FUELS**

Oil prices fell sharply in 2008 Q4, while growth in natural gas prices remained high

(annual percentage changes)



**TABLE II.7 STRUCTURE OF THE IMPORT PRICE INDEX**

Prices fell in most import categories

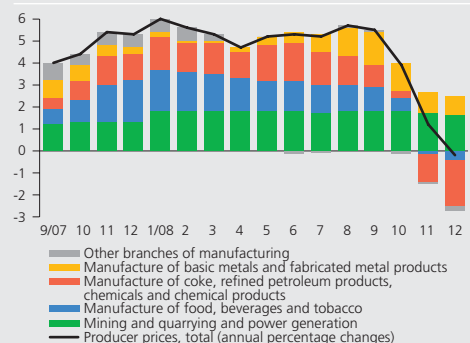
(annual percentage changes)

|                                                   | 8/08  | 9/08 | 10/08 | 11/08 |
|---------------------------------------------------|-------|------|-------|-------|
| IMPORTS, TOTAL                                    | -3.5  | -1.7 | -1.0  | -1.7  |
| of which:                                         |       |      |       |       |
| food and live animals                             | -1.6  | -1.7 | -1.4  | -1.2  |
| beverages and tobacco                             | -4.4  | -6.1 | -4.3  | -3.9  |
| crude materials inedible, except fuels            | 7.4   | 12.5 | 18.4  | 24.6  |
| mineral fuels and related products                | 31.8  | 29.6 | 22.3  | -1.5  |
| animal and vegetable oils                         | 7.0   | 5.5  | 4.0   | 6.6   |
| chemicals and related products                    | -4.2  | -2.4 | -1.6  | -2.0  |
| manufactured goods classified chiefly by material | -6.5  | -3.7 | -3.0  | -1.5  |
| machinery and transport equipment                 | -10.9 | -8.8 | -6.5  | -4.0  |
| miscellaneous manufactured articles               | -8.2  | -6.7 | -4.4  | -0.6  |

**CHART II.50 INDUSTRIAL PRODUCER PRICES**

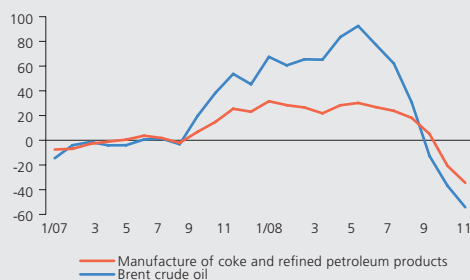
The decline in industrial producer prices was driven by the oil-processing and food industries

(annual percentage changes; contributions in percentage points)

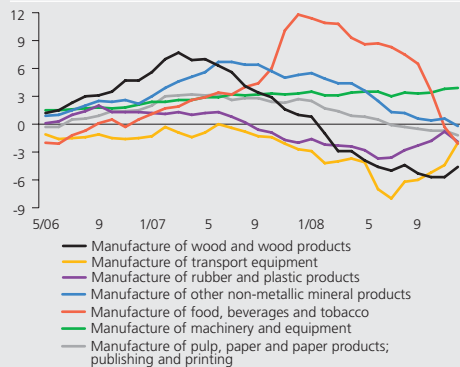


23 Coal mining and electricity, gas and water supply.

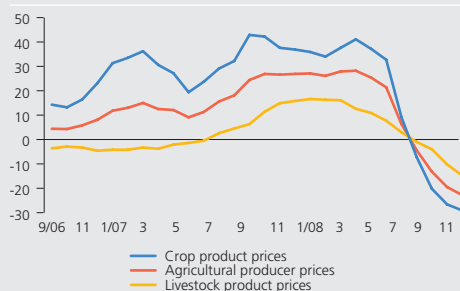
**CHART II.51 PRICES IN THE OIL-PROCESSING INDUSTRY**  
**Producer prices in the oil-processing industry decreased in line with world oil prices**  
 (annual percentage changes)



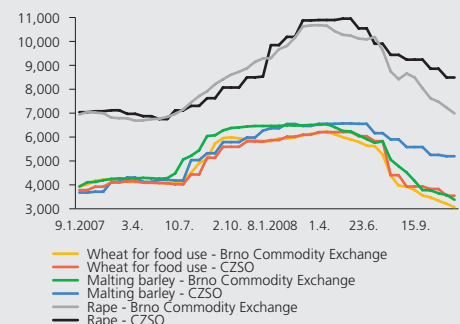
**CHART II.52 PRICES IN SELECTED BRANCHES**  
**Producer prices declined in most branches of manufacturing**  
 (annual percentage changes; selected branches)



**CHART II.53 AGRICULTURAL PRODUCER PRICES**  
**The decline in agricultural producer prices increased sharply in 2008 Q4**  
 (annual percentage changes)



**CHART II.54 COMMODITY PRICES**  
**Prices of the main crop commodities continued to fall**  
 (CZK/ton; selected commodities)



situation on the global agricultural and food commodity market, which also affected domestic agricultural producer prices (for more details, see *Agricultural producer prices*). According to the latest figures for December, producer prices in the food industry decreased by 2.1% year on year (after having grown by 6.5% in September). Industries with falling prices also prevailed in the other branches of manufacturing<sup>24</sup> in Q4.

By contrast, the electricity, gas and water supply industry continued to show fast price growth (10% in December), linked chiefly with prices of electricity abroad. The very rapid price growth in mining and quarrying weakened considerably, but remained high (11.1% in December). Fast, albeit moderating producer price inflation also continued in the manufacture of basic metals and fabricated metal products. This was due to prices of key materials and energy-producing inputs.

In addition to the sharp fall in world prices of oil and food, the significant change in industrial producer prices in Q4 was due to slowing demand. This was an important factor in producers' decision-making on price changes amid falling prices of products imported by their competitors. This factor was particularly apparent in other branches of manufacturing, where prices were already mostly falling.

### Agricultural producer prices

Agricultural producer prices had been falling since 2008 Q3, when a significant change in trend was recorded (see Chart II.53). The annual decline accelerated sharply in Q4, reaching 22.8% in December. This significant change was due not only to crop product prices, but also to livestock product prices.

The sizeable annual decline in agricultural producer prices in the Czech Republic was due to a combination of several factors, most notably a change in prices of crop commodities on world markets in mid-2008, the above-average domestic harvest in 2008 and the persisting – albeit declining – annual appreciation of the koruna's exchange rate. The decline in agricultural commodity prices on world markets in summer 2008 was associated mainly with weakening growth in world demand and above-average harvests in the major world producers (Australia, the USA and the euro area) and thus with growth in the previously low stocks. According to CZSO estimates, the domestic harvest was the second largest<sup>25</sup> since 1990. Koruna prices of major crop commodities thus started to decline at the end of last year's harvest, decreasing by 7.2% year on year in September and falling significantly further in the subsequent months (to -29.1% in December).

The deepening annual decline in livestock product prices, observed since the end of Q3, also continued into 2008 Q4. As with crop products, their annual growth turned into a decline in September (of 1%), which deepened further in Q4, to -14.8% in December. This was mainly due to a decline in livestock product prices on world markets, whose impact on domestic prices was magnified by the annual appreciation of the koruna-dollar exchange rate.

<sup>24</sup> All industrial branches excluding mining and quarrying, electricity, gas and water supply, manufacture of coke and refined petroleum products and the food industry.

<sup>25</sup> The largest harvest was recorded in 2004.



### Other producer prices

In the other producer price categories, comprising services and construction, less significant changes in prices than in industry and agriculture were observed in 2008 Q4. However, the direction of these changes also suggested a dampening impact of weakening demand. Some change in trend can be observed in construction. The long-running gradual rise in annual growth in this sector turned into an opposite trend in July: annual price growth slowed by 1.3 percentage points compared to June, to 3.8% in December (see Chart II.55). Slower price growth was also recorded for the materials and products consumed in construction (to 0.5% year on year in December).

Annual market services price inflation in the business sector remained broadly flat at the previous quarter's level in Q4; although it increased slightly in October and November, it returned to the September level in December (4%). This was mostly due to prices in business services and renting services, which recorded an annual rise of 5.5% in December. Only freight transport recorded a sizeable slowdown in inflation (from 4% in September to 2.1% in December). This was clearly linked with declining fuel prices.

## II.8 INFLATION

*The sharp slowdown in annual consumer price inflation in 2008 Q4 primarily reflected the subsiding of the inflationary shocks observed in the previous year and the anti-inflationary effect of external factors at the end of 2008. Lower cost pressures were fostered mainly by a significant change of trend in prices of oil and agricultural and food commodities on world markets. The moderation of inflation was also due to a continuing decline in domestic demand. In December, headline inflation fell below the upper boundary of the CNB's inflation-target tolerance band, while monetary policy-relevant inflation fell below its lower boundary. With the benefit of hindsight, and taking account of the volatile cost factors over the last six quarters, the past monetary policy settings can be assessed as having been broadly appropriate.*

### II.8.1 Current inflation

Annual inflation<sup>26</sup> fell sharply in 2008 Q4 (see Chart II.56). At 3.6% in December, it was 3 percentage points lower than in September. This significant decline in inflation in Q4 was fostered by market prices, in particular prices of food. Fuel prices and, to a lesser extent, adjusted inflation also helped significantly to reduce inflation. The downward effect of market prices on inflation was only partly offset by an annual increase in regulated prices. This means that after a year-long deviation, inflation returned below the upper boundary of the tolerance band set by the CNB around its target of 3%. Monetary-policy relevant inflation, which was again well below annual headline inflation in Q4 (1.8% in December), fell significantly below the inflation target.

The continuing decline in inflation was due to various factors of both external and domestic origin. The significant decrease in 2008 Q4 was largely expected, as the effect of the shocks observed at the end of the previous year in the form of strong growth in world prices of energy-producing materials and food had faded away. However, this effect was bolstered by a change of trend in prices of

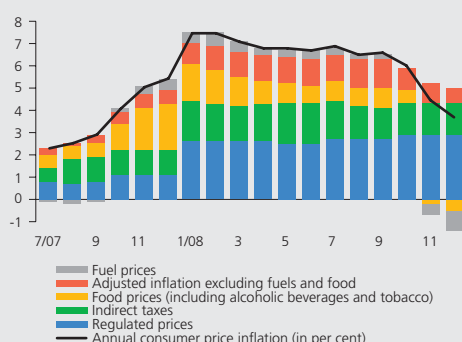
CHART II.55 OTHER PRODUCER PRICES

Construction work price inflation continued to fall  
(annual percentage changes)

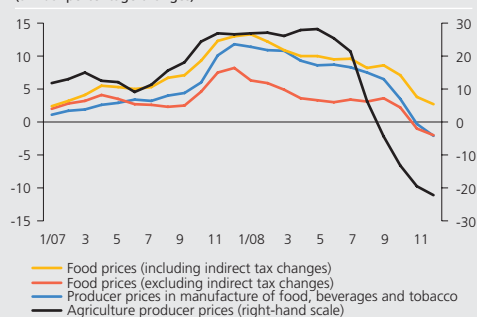


**CHART II.58 STRUCTURE OF INFLATION**

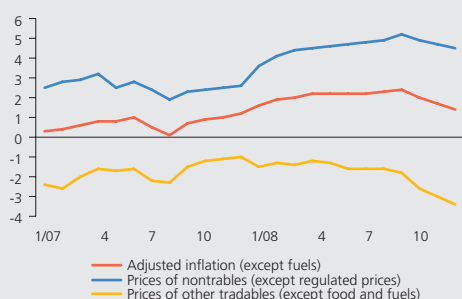
**Consumer price inflation was again driven mainly by regulated prices and changes to indirect taxes in 2008 Q4**  
(annual percentage changes; contributions in percentage points)

**CHART II.59 FOOD PRICES**

**Food price inflation was strongly affected by falling agricultural producer prices**  
(annual percentage changes)

**CHART II.60 ADJUSTED INFLATION EXCLUDING FUELS**

**Adjusted inflation excluding fuels declined in 2008 Q4**  
(annual percentage changes)



oil and many agricultural and food commodities on world markets, culminating in an annual decline in those prices. The falling oil prices passed through to market prices of fuels with a short lag via import prices and producer prices in oil processing and, at the same time, gave rise to a decline in cost pressures in other sectors. The change of trend in food prices on world markets also fostered lower input prices of imported food for the domestic consumer market. The annual appreciation of the koruna-euro exchange rate also acted in the same direction, albeit to a lesser extent than in previous quarters.<sup>27</sup>

At the same time, domestic price inflation was dampened by the continuing slowdown in domestic demand and the long-running decline in import prices of products with a higher degree of processing. This was reflected in low growth, or a decline, in consumer prices in some commodity groups. Real growth in consumer demand was visibly lower in Q3 than in 2007, and according to the latest partial retail market indicators this slowdown accelerated at the end of 2008.

Consumer price inflation was thus driven by regulated prices in 2008 Q4, which continued to rise apace as observed in previous quarters (by 17.1% in December; see Chart II.58). The high consumer price inflation was largely a result of changes made to regulated items in Q1, when energy prices were increased significantly, fees in health care were introduced and VAT rose from 5% to 9%.<sup>28</sup> Further growth in regulated price inflation in Q4<sup>29</sup> was fostered by a rise in natural gas prices for households (of 10%) in October and by increases in heat prices (1.5%) and rail fares (3.4%) in December. Another administrative effect contributing to annual consumer price inflation was an increase in VAT in unregulated prices, which will disappear from the annual CPI growth in 2009 Q1.

Market prices in all the monitored categories tended towards lower growth or a deeper decline. Annual growth in food prices (excluding tax changes) moderated to 2.2% in October and switched to an annual decline in November (of 2% in December).<sup>30</sup> As mentioned in previous sections of this Inflation Report, this was due mainly to a decline in world prices of many foodstuffs and in domestic agricultural producer prices. Annual inflation in the food industry subsequently moderated and producer prices in this sector have been recording an annual decline since November. Prices of agricultural and food products were also partly affected by the previous year's high base. The decline in food prices was probably also fostered by weakening consumer demand amid low growth in real household income, as consumption of non-durable goods was flat or moderately falling year on year in 2008 according to CZSO statistics.

Annual adjusted inflation excluding fuels also fell in 2008 Q4 (to 1.4% in December). As in previous quarters, it was driven by prices of non-tradable commodities, as prices of tradable commodities deepened the annual decline.

The long-running annual decline observed in the category of tradable commodities (excluding food and fuels) increased somewhat in Q4. The decline in these prices had previously been due mainly to a combination of an appreciating koruna (in particular the koruna-euro exchange rate) and subdued prices of these commodities abroad. After the dampening effect of the exchange rate dropped out in Q4, the main cause was evidently a fall in prices in some categories of major commodities, led by efforts

<sup>27</sup> The annual depreciation of the koruna-dollar exchange rate since November was by now acting in the opposite direction.

<sup>28</sup> The year-on-year growth in these items was high. In December, for example, regulated rents went up by 22.2%, regulated items in health care by 41.9%, natural gas by 34%, electricity by 9.5%, etc.

<sup>29</sup> Their annual growth rose by 1.4 percentage points in December 2008 compared to September.

<sup>30</sup> Food prices including tax changes rose by 2.7% in December.

to boost sales amid weakening consumer demand (in particular for used and new cars and electronic goods).<sup>31</sup> The fall in car prices was due mainly to the global slump in demand for cars at a time of slowing economic growth. As regards used cars, there was also the effect of new administrative measures under which fees for transfers of old cards and an obligation to pay third-party insurance for unused cars will be introduced in 2009.

Prices of non-tradable commodities (mainly services) also helped to reduce adjusted inflation in Q4. Their long-running gradual upward trend halted and service providers started to adjust their prices to the changing situation on the demand side in Q4. This resulted in a slight fall in annual service price inflation from 5.2% in September to 4.5% in December. The slower inflation here was also probably due to falling food prices, which led to lower price growth in hotels and restaurants. In addition, telephone charges fell significantly in December.

Fuel prices were significantly affected in 2008 Q4 by the fall in oil prices on world markets since July 2008. This culminated in a sizeable year-on-year decline in fuel prices in 2008 Q4 (of more than 20% in December; see Chart II.57).

Looking at consumer prices broken down by the major categories of the consumer basket, the aforementioned main anti-inflationary factors were most apparent in prices of food and non-alcoholic beverages and transport (see Chart II.61). By contrast, the contribution of prices in the category of non-alcoholic beverages and tobacco to the rise in inflation remained positive, since tobacco was being sold at prices inclusive of increased excise duty (as from 1 January 2008). However, prices in the housing category, mainly reflecting increases in prices of regulated items in 2008 (particularly gas, regulated rents, electricity and heat), remained the biggest contributor to inflation.

By international comparison, consumer prices, as measured by the HICP, continued to rise faster in the Czech Republic in 2008 Q4 than on average in the EU countries. The main causes of this persisting difference remain unchanged from the previous Inflation Report. The primary reason was the reform measures implemented in the Czech Republic at the start of 2008, which affected consumer prices throughout 2008. According to Eurostat's latest estimate, annual HICP inflation was 2.2% in the EU countries and 3.3% in the Czech Republic in December.

## II.8.2 Fulfilment of the inflation target

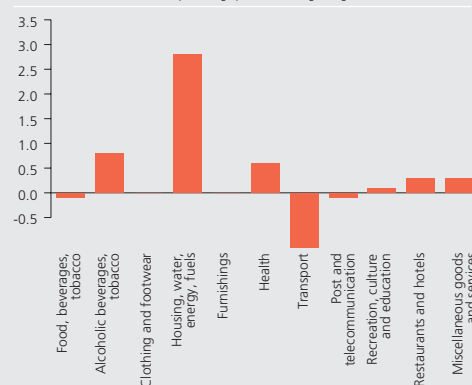
Average headline inflation remained above the upper boundary of the CNB's inflation target in 2008 Q4 (see Chart II.63), but fell significantly towards it. Monetary-policy relevant inflation was broadly at the level of the inflation target in 2008 Q4. This section of the Inflation Report briefly analyses the contribution of the CNB's monetary policy to this situation.

In order 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 2008 Q4 is thus roughly from April to December 2007. 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 2007 with inflation in 2008 Q4.

**CHART II.61 CONSUMER BASKET PRICES**

**Prices in the housing category and tobacco prices were the biggest contributors to annual inflation**

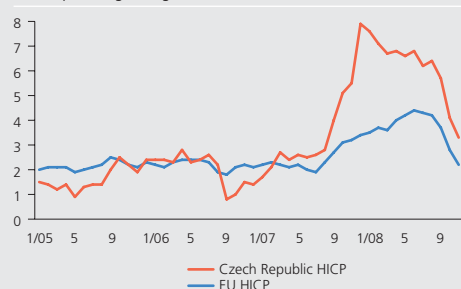
(December 2008; contributions in percentage points, including changes to indirect taxes)



**CHART II.62 THE HICP IN THE CZECH REPUBLIC AND THE EU**

**Inflation in the Czech Republic remained above the EU average in 2008 Q4**

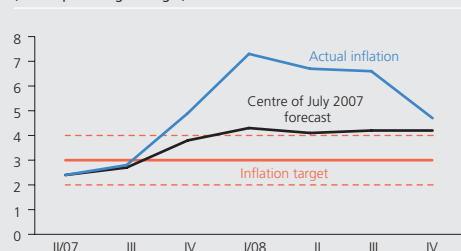
(annual percentage changes)



**CHART II.63 FORECAST VERSUS ACTUAL INFLATION**

**Actual inflation in 2008 Q4 was above the July 2007 forecast**

(annual percentage changes)



<sup>31</sup> Prices of used cars declined by about 10% in October. This was followed by a decline in prices of new cars in November. According to the CZSO, prices of cars were down by 12.2% year on year in December. Prices of electronic goods were reduced in the pre-Christmas period in order to stimulate demand.



**TABLE II.8 FULFILMENT OF THE INFLATION FORECAST**

**Regulated prices and the first-round impacts of changes to indirect taxes were significantly higher than forecasted, while the other components of inflation were markedly lower**

(annual percentage changes; contributions in percentage points)

|                                                     | July 2007<br>forecast | 2008 Q4<br>outturn | Contribution<br>to total<br>difference <sup>a)</sup> |
|-----------------------------------------------------|-----------------------|--------------------|------------------------------------------------------|
| CONSUMER PRICES                                     | 4.2                   | 4.7                | 0.5                                                  |
| Breakdown into contributions:                       |                       |                    |                                                      |
| regulated prices                                    | 5.5                   | 16.9               | 2.0                                                  |
| first-round impacts of changes<br>to indirect taxes | 0.4                   | 1.4                | 1.1                                                  |
| food prices <sup>b)</sup>                           | 3.3                   | -0.3               | -0.9                                                 |
| fuel prices <sup>b)</sup>                           | 5.7                   | -11.5              | -0.7                                                 |
| adjusted inflation excl. fuels <sup>b)</sup>        | 3.5                   | 1.7                | -1.0                                                 |

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

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

The July 2007 forecast predicted a gradual rise in inflation during 2007 from the lower boundary of the tolerance band of the inflation target to above its upper boundary, where it was expected to remain until the end of 2008 (see Chart II.63). An increase in all the components of inflation was forecasted. The inflationary effect of the domestic real economy and the contribution of administrative effects to inflation were expected to peak in 2008 Q1. A rise in inflation expectations as a result of the lagged effects of these factors was expected to help keep inflation at higher levels in the course of 2008.

Headline inflation in reality was well above the forecast as from 2007 Q4. The developments in late 2007 and early 2008 reflected high growth in world prices of energy-producing materials and food and the implementation of reform measures. The deviation of actual inflation from the forecast in 2008 Q4 was caused by considerably higher growth in regulated prices and greater impacts of changes to indirect taxes on the one hand, and quite substantial anti-inflationary deviations of other components on the other hand (see Table II.8).

The effect of the external environment on domestic inflation was characterised by higher-than-expected external inflation and oil prices. The inflationary effect of these factors was counteracted by a weaker dollar-euro exchange rate on average and by a sharp fall in external demand in the second half of 2008 (see Table II.9).

The monetary policy settings in the key period were quite significantly different from the expectations of the forecast. Both nominal and real rates were easier than assumed by the July forecast, whereas the exchange rate was substantially stronger as from 2007 Q4.

Revisions to the quarterly data on economic growth, made in connection with the publication of the annual national accounts for 2007, also had an effect on the fulfilment of the forecast. The quarterly GDP growth estimates in 2007 were revised downwards compared to the data used in the forecast.

Based on the CNB's current knowledge of the workings of the Czech economy and its current knowledge of actual economic developments, the developments since the July 2007 forecast was drawn up can be summed up in the following way. Inflation was affected by significant cost shocks in the form of a surge in world prices of food and energy in the second half of 2007, higher-than-forecasted growth in regulated prices and a rise in the lower VAT rate at the start of 2008. However, the pronounced price growth associated with these factors was one-off in nature. The decline of the relatively high inflation was also fostered by a fall in world prices of oil and food at the end of 2008. Real economic activity grew rather more slowly compared to the July forecast. This was due (from the current perspective) to lower initial economic growth, a considerably tighter exchange rate and, in recent quarters, to the emerging real economic impacts of the financial crisis. Nominal wage growth was higher than expected, even when adjusted for the one-off factors in 2008 Q1 (see Table II.10).

In addition to the message of the forecast, 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 2007 (see the relevant minutes), the Bank Board assessed the risks of the forecasts as being on both the upside and the downside. The Bank Board's decisions led to easier monetary policy settings than those corresponding to the recommendations of the forecasts. Looking at the cost factor volatility evident since the second half of 2007, the easier monetary policy led to fulfilment of the inflation target given application of the escape clause regarding the first-round effects of the changes to indirect taxes.

**TABLE II.9 FULFILMENT OF THE EXTERNAL ASSUMPTIONS**

**The effect of external price developments on the domestic economy was more inflationary compared to the July 2007 forecast**

(annual percentage changes unless otherwise indicated)

|                                      |   | III/07 | IV/07 | I/08 | II/08 | III/08 | IV/08 |
|--------------------------------------|---|--------|-------|------|-------|--------|-------|
| GDP in euro area <sup>a)</sup> b) c) | p | 2.6    | 2.2   | 2.1  | 2.4   | 2.4    | 2.3   |
|                                      | o | 2.6    | 2.0   | 2.4  | 2.1   | 1.2    | -     |
| CPI in euro area <sup>b)</sup> c)    | p | 1.9    | 2.0   | 1.9  | 1.8   | 1.7    | 1.7   |
|                                      | o | 2.1    | 2.9   | 3.0  | 3.2   | 3.4    | 2.0   |
| 1Y EURIBOR <sup>d)</sup>             | p | 4.5    | 4.6   | 4.7  | 4.7   | 4.7    | 4.7   |
| (percentages)                        | o | 4.5    | 4.7   | 4.5  | 4.9   | 5.0    | 4.2   |
| USD/EUR exchange rate                | p | 1.35   | 1.35  | 1.35 | 1.34  | 1.33   | 1.33  |
| (levels)                             | o | 1.37   | 1.45  | 1.50 | 1.56  | 1.50   | 1.32  |
| Brent crude oil price                | p | 69.7   | 71.0  | 71.9 | 72.4  | 72.5   | 72.4  |
| (USD/barrel)                         | o | 74.9   | 88.8  | 96.5 | 122.2 | 115.9  | 56.2  |

p - prediction, o - outturn

a) at constant prices

b) seasonally adjusted

c) effective indicator

d) outturn measured by 3M EURIBOR

**TABLE II.10 FULFILMENT OF THE FORECAST FOR KEY VARIABLES**

**The exchange rate was considerably stronger than forecasted**

|                                |   | III/07 | IV/07 | I/08 | II/08 | III/08 | IV/08 |
|--------------------------------|---|--------|-------|------|-------|--------|-------|
| 3M PRIBOR                      | p | 3.4    | 4.1   | 4.6  | 4.8   | 5.0    | 5.1   |
| (percentages)                  | o | 3.3    | 3.8   | 4.0  | 4.2   | 3.9    | 4.1   |
| CZK/EUR exchange rate          | p | 28.3   | 28.2  | 28.1 | 28.0  | 27.8   | 27.6  |
| (levels)                       | o | 27.9   | 26.8  | 25.6 | 24.8  | 24.1   | 25.3  |
| Real GDP <sup>a)</sup>         | p | 6.1    | 6.2   | 5.8  | 5.5   | 5.3    | 5.0   |
| (annual perc. changes)         | o | 6.6    | 6.3   | 5.4  | 4.5   | 4.0    | -     |
| Nominal wages <sup>a)</sup> b) | p | 7.9    | 7.9   | 7.9  | 8.1   | 8.5    | 9.0   |
| (annual perc. changes)         | o | 7.8    | 8.3   | 9.1  | 9.1   | 8.9    | -     |

p - prediction, o - outturn

a) seasonally adjusted

b) in the business sector; adjusted for estimated impacts of tax optimisation and lower sickness rate in 2008 Q1

### III.1 SUMMARY OF THE STARTING CONDITIONS

*Headline inflation fell significantly towards the CNB's inflation target in 2008 Q4. Real GDP growth slowed gradually during 2008, as did employment growth and nominal wage growth. The current economic situation is thus still assessed as being a decline from the peak of the business cycle, but the decline is faster than assumed by the previous forecast. Domestic inflationary pressures in the economy are subsiding rapidly. However, the anti-inflationary pressures arising from the strong koruna in the first three quarters of 2008 are also fading as the exchange rate depreciates. Overall, the current inflation pressures are assessed as being anti-inflationary, but their intensity has decreased significantly owing to the weakening exchange rate.*

Inflation fell significantly in 2008 Q4. By December, it was within the tolerance band of the inflation target. Monetary-policy relevant inflation, i.e. inflation adjusted for the first-round effects of changes to indirect taxes, even declined below 2% in December. The prediction of the previous forecasts that inflation would begin to fall towards the target at the end of 2008 thus materialised, although this fall was sharper than expected owing to external developments. Annual inflation continues to be driven mainly by increases in regulated prices and changes to indirect taxes, whose total contribution to inflation exceeded 4 percentage points at the end of last year. Food prices adjusted for changes to indirect taxes declined in year-on-year terms in Q4 as a result of a rapid decrease in world prices of agricultural commodities. Fuel prices fell by more than 11% year on year in response to the sharp decline in oil prices. Adjusted inflation excluding fuels also slowed considerably. A large part of this slowdown can be attributed to falling prices of new and used cars.

The annual growth of the Czech economy continued to slow gradually in 2008 Q3 from the high rates of growth recorded earlier. The decline in GDP growth was due mainly to a fall in gross capital formation and, within it, by a significant year-on-year decline in inventory investment. Fixed investment growth slowed as a result of falling external demand and low corporate profitability. The contribution of household consumption to GDP also fell quite substantially, as did that of net exports, which, however, still remained high. The forecast assumes that annual economic growth will slow significantly to around 2% in 2008 Q4, chiefly as a result of a smaller contribution of net exports. This reflects the marked turnaround in the monthly output and trade figures that occurred in Q4.

The labour market situation corresponds to the downward phase of the business cycle. Employment growth, including growth in the employment of foreigners, is slowing. The seasonally adjusted registered unemployment rate started to rise in Q4. The number of vacancies is continuing to decrease. In line with the downswing in economic growth and labour demand, the forecast assumes a sizeable decline in the growth rate of wages in 2008 Q4.

Import prices continued to fall in 2008 Q3 as a result of the past exchange rate appreciation. However, the sharp weakening of the exchange rate at the close of 2008 will lead to a gradual acceleration of import prices in 2009 despite declines in external inflation and world energy prices. At the same time, export prices in foreign currency will decrease, boosting the price competitiveness of domestic exporters.

Based on the above developments and other information, the current inflation pressures are assessed as being anti-inflationary. However, their anti-inflationary effect weakened considerably at the end of last year. The effect of domestic factors remains inflationary, owing chiefly to wages, but is subsiding quickly. However, part of the decrease in inflation in 2008 Q4 is interpreted as being a consequence of a one-off decline in prices of fuels, food and other components of the consumer basket

which is not directly linked with the cyclical position of the economy. The inflationary effects of domestic factors in the overall inflation pressures continue to be dampened by the lagged anti-inflationary effect of the exchange rate appreciation in the first three quarters of 2008.

### III.2 THE FORECAST

*Inflation will continue to fall this year and will approach zero in mid-2009. In Q4, however, it will start rising again and approach the 2% inflation target, which it will hit in 2010 H1. The forecast is for a sharp slowdown in economic growth owing to the global financial and economic crisis. On average, economic growth is expected to be zero or slightly negative this year and around 1% next year. The nominal exchange rate will initially correct its depreciation observed at the beginning of 2009 and will be broadly stable thereafter. Consistent with the forecast is a decline in market interest rates.*

#### III.2.1 Assumptions of the forecast

The forecast is based on the starting conditions summarised in section III.1 and on assumptions regarding the external economic environment, regulated prices, indirect tax changes and public budgets.

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 on market outlooks. The current forecast is based on the January Consensus Forecasts data and the market outlooks effective on the survey date. Effective developments in the euro area are used to proxy for developments in the Czech Republic's major trading partner economies. The CNB forecast uses the outlook for prices of Brent crude oil as an indicator of energy prices. In addition, the outlook for petrol prices on the ARA markets is used in forecasting fuel prices.

**TABLE III.1 EXPECTED EXTERNAL DEVELOPMENTS**  
The forecast assumes a marked decrease in external demand and in foreign inflation pressures  
(quarterly averages)

|                                            | I/09 | II/09 | III/09 | IV/09 | I/10 | II/10 | III/10 |
|--------------------------------------------|------|-------|--------|-------|------|-------|--------|
| Brent crude oil prices (USD/barrel)        | 46.0 | 49.6  | 53.6   | 56.4  | 58.8 | 61.1  | 62.8   |
| GDP in euro area <sup>a)</sup>             | -2.4 | -2.2  | -1.8   | 0.3   | 0.7  | 0.8   | 0.8    |
| Producer prices in euro area <sup>a)</sup> | 3.9  | 1.0   | -1.2   | -0.1  | 0.8  | 1.8   | 2.4    |
| Consumer prices in euro area <sup>a)</sup> | 1.5  | 0.9   | 0.6    | 1.1   | 1.3  | 1.6   | 1.7    |
| USD/EUR exchange rate                      | 1.36 | 1.32  | 1.32   | 1.33  | 1.33 | 1.33  | 1.33   |
| 3M EURIBOR (in per cent)                   | 2.7  | 1.7   | 1.5    | 1.4   | 1.7  | 2.1   | 2.7    |

a) effective indicator; annual percentage changes

The continuing financial and economic crisis is reflected in a substantial deterioration of the prospects for economic growth in all the world's economies, including the euro area. Effective euro area GDP should decrease by 1.5% this year and rise by 0.8% in 2010. The sharp slowdown in economic growth combined with falling prices of oil, other raw materials and agricultural commodities will exert downward pressure on external inflation this year. Growth of only 1% in the effective indicator of consumer prices in the euro area is expected in 2009, followed by an increase to 1.6% in 2010. Similar developments are forecasted for producer prices, which should rise by 0.9% in 2009 and 1.9% in 2010.

International financial institutions and central banks, including the ECB, are combating the ongoing crisis and the related sharp economic slowdown by rapidly easing monetary policy. The expected path of future foreign interest rates thus declined further. According to market outlooks, three-month euro rates adjusted for the credit premium are expected to decrease this year to levels close to 1% and subsequently to increase to around 3% towards the end of next year as inflation rises and GDP recovers. Given the forecast assumption of a gradual decline in the credit premium to low levels this year, this implies somewhat higher average EURIBOR rates in 2009. The expected average three-month EURIBOR foreign interest rate is 1.9% this year and 2.4% in 2010. The expected path of the dollar-euro exchange rate together with the current appreciation of the dollar exchange rate shifted to stronger levels in 2009. The dollar is thus expected to be flat at just above USD 1.3/EUR in 2009 and 2010. A sizeable downward revision was made

to the outlook for oil and petrol prices. At the forecast horizon, the price of Brent crude oil should gradually rise from USD 46 a barrel at the start of this year to USD 64 a barrel at the end of 2010.

The forecast assumes that domestic regulated prices will contribute significantly less to headline inflation in the coming two years compared to the previous year, when regulated prices rose by more than 17%. Regulated prices will increase in the coming two years primarily because of rent deregulation. The forecast also assumes that regulated prices of electricity will increase this year and remain flat in 2010. Natural gas prices for households are expected to decrease substantially this year, but will rebound in 2010. Regulated prices are thus projected to increase by around 3% at the end of this year and by 5% at the end of 2010.

The assumptions of the forecast also include the outlook for the first-round effects of indirect tax changes, which are subject to escape clauses. The first-round effects of the VAT increase and harmonisation of excise duties and environmental taxes with EU rules which took place in 2008 will affect annual consumer price inflation until mid-2009. The first-round effect of changes to indirect taxes is assumed to be zero from the second half of this year.

The estimated government sector deficit in 2008 has been revised to 1.0% of GDP based on the available data on state and local budget performance. Given the deterioration in the macroeconomic outlook, the estimated government sector deficit has been significantly increased in 2009 and 2010. The lower economic growth will be reflected in a slowdown in tax revenues and revenues from social security contributions. The tax revenue shortfall will be only partly offset by lower government investment activity. The public finance deficit is likely to remain below 3% of GDP in 2009 and will slightly exceed this level to stand at 3.3% GDP in 2010 if no additional adjustment measures are taken. According to the current forecasts, however, the structural public budget deficit will not exceed 3% of GDP.

#### III.2.2 The message of the forecast

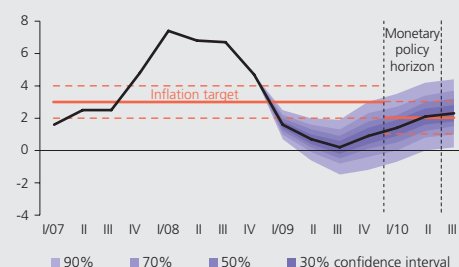
Headline inflation will continue to fall this year and will approach zero in the middle of the year. In Q4, however, it will start rising again and approach the 2% inflation target valid from the beginning of 2010. At the monetary policy horizon, i.e. in 2010 H1, headline inflation will be roughly at the inflation target level (see Chart III.1).

Monetary-policy relevant inflation, i.e. inflation adjusted for the first-round effects of changes to indirect taxes, will differ from headline inflation only in the first half of this year. The forecast for monetary-policy relevant inflation is subsequently identical to that for headline inflation.

Although the contribution of regulated prices to headline inflation will decline considerably this year, it will account for about one-half of headline consumer price inflation in 2009 and 2010. The other components of inflation will at first reflect the still anti-inflationary starting conditions and the impacts of the decline in world prices of food and energy. The subsequent rise in inflation will be caused by inflationary pressures due to a weaker exchange rate, which will be only partly offset by anti-inflationary domestic factors. Adjusted inflation excluding fuels will decline in the first half of 2009 as a result of falling household consumption and the still anti-inflationary effect of the past values of the exchange rate. Subsequently, adjusted inflation will be affected by a weaker exchange rate and the lagged effect of the currently increasing nominal unit wage costs. The decline in food prices excluding tax changes will deepen this year as a result of a decrease in world agricultural producer prices and food prices. In 2010, food prices will gradually

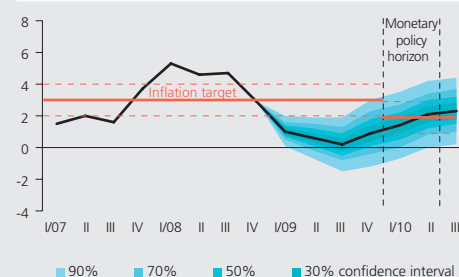
**CHART III.1 THE HEADLINE INFLATION FORECAST**

**At the monetary policy horizon, the headline inflation forecast hits the 2% inflation target valid from 2010**  
(annual percentage changes)



**CHART III.2 THE MONETARY-POLICY RELEVANT INFLATION FORECAST**

**At the monetary policy horizon, monetary-policy relevant inflation is the same as headline inflation**  
(annual percentage changes)



**TABLE III.2 FORECAST OF KEY INFLATION COMPONENTS****Non-regulated prices will decline on average**

(annual percentage changes; quarterly averages)

|                                                                              | I/09  | II/09 | III/09 | IV/09 | I/10 | II/10 | III/10 |
|------------------------------------------------------------------------------|-------|-------|--------|-------|------|-------|--------|
| CONSUMER PRICES                                                              | 1.6   | 0.7   | 0.2    | 0.9   | 1.4  | 2.1   | 2.3    |
| Regulated prices <sup>a)</sup>                                               | 10.8  | 7.6   | 5.5    | 3.3   | 0.5  | 3.2   | 4.3    |
| First-round impacts of indirect tax changes on consumer prices <sup>b)</sup> | 0.6   | 0.1   | 0.0    | 0.0   | 0.0  | 0.0   | 0.0    |
| Net inflation <sup>c)</sup>                                                  | -1.2  | -1.6  | -1.6   | -0.4  | 1.3  | 2.0   | 2.0    |
| Prices of food, beverages, tobacco <sup>d)</sup>                             | -1.4  | -2.3  | -3.0   | -2.9  | -0.7 | 1.7   | 2.0    |
| Adjusted inflation excl. fuels <sup>d)</sup>                                 | 0.9   | 0.7   | 0.7    | 1.3   | 1.6  | 1.6   | 1.7    |
| Fuel prices <sup>d)</sup>                                                    | -26.4 | -27.9 | -24.4  | -6.3  | 11.5 | 9.0   | 6.9    |
| Monetary-policy relevant inflation <sup>d)</sup>                             | 1.0   | 0.6   | 0.2    | 0.9   | 1.4  | 2.1   | 2.3    |

a) including changes to indirect taxes

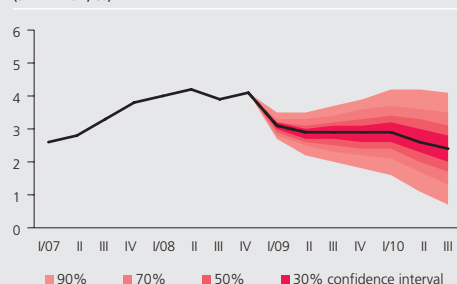
b) contributions in percentage points

c) excluding changes to indirect taxes

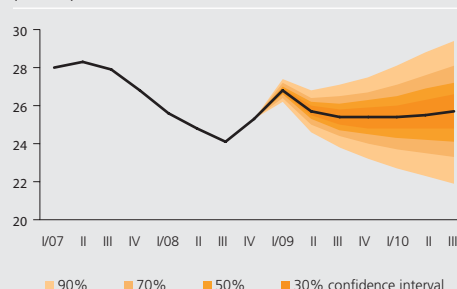
d) headline inflation excluding first-round impacts of changes to indirect taxes

**CHART III.3 THE INTEREST RATE FORECAST****Consistent with the forecast is a decline in market interest rates**

(3M PRIBOR, %)

**CHART III.4 THE EXCHANGE RATE FORECAST****The nominal exchange rate will initially correct its depreciation observed at the beginning of 2009 and will then be broadly stable**

(CZK/EUR)



return to growth. The annual decline in fuel prices will also continue this year in response to the fall in oil prices; the movements of the koruna's exchange rate against the dollar will dampen this decline only slightly. Fuel prices will renew annual growth in 2010.

Consistent with the forecast is a decline in market interest rates (see Chart III.3). The sizeable decline in market interest rates at the start of this year from their initial level, which was affected by a high credit premium, is a result of anti-inflationary inflation factors and also of the short-term outlook for interest rates abroad. Interest rates are flat for the remainder of this year, with inflationary pressures and declining foreign rates affecting them in opposite directions. As a result, the positive interest rate differential will widen in the remainder of this year amid a continuing decline in foreign rates. After the inflationary pressures subside in 2010 and the improving external demand outlook, coupled with still low – albeit gradually rising – foreign interest rates, renews the appreciation pressures on the exchange rate, interest rates will decline slightly further in 2010.

The nominal exchange rate of the koruna against the euro, which is depreciating in 2009 Q1, will correct its losses in Q2 due to the widening of the positive interest rate differential. The koruna's exchange rate should be broadly flat in the remainder of 2009 and in 2010, with the depreciation pressures stemming mainly from the declining external demand being dampened by a widening of the interest rate differential into positive values in the coming quarters and the subsequent recovery in external demand being counteracted by a re-opening negative differential (see Chart III.4). Box 2 describes the depiction of the exchange rate in the g3 model in more detail.

**BOX 2****The exchange rate path in the g3 model**

The exchange rate path in the g3 model is determined primarily by the uncovered interest parity condition. According to this condition, the current exchange rate level is determined by the expected exchange rate level and the size of the interest rate differential between the domestic and foreign interest rate adjusted for the risk premium. The expected exchange rate is determined in a model-consistent manner and depends on both the endogenous and exogenous variables of the model. The risk premium takes into account short-term exchange rate volatility and the trend reflecting the stock of net external assets, with, for example, a higher debt ratio of the domestic economy resulting in an increase in the risk premium and exerting depreciation pressures on the currency.

In the Czech economy, however, the uncovered interest parity condition fails to describe sufficiently the observed movements of the exchange rate, which in reality shows some persistence. In the g3 model, therefore, the uncovered interest parity condition is adjusted to include a certain degree of stickiness. Although this adjustment is not based on microeconomic foundations, it helps us to replicate the real data, as it was calibrated by comparing the model characteristics with the observed data.

The exchange rate forecast for the first quarter of the forecast is additionally adjusted based on the results of simulations of satellite models that use a wider set of short-term information than the core model and based on the recent values of the exchange rate.

The forecast expects a sharp slowdown in economic growth (see Chart III.5). After recording almost 4% growth in 2008, the Czech economy will slow to zero or slightly negative growth on average this year owing to the global financial and economic crisis. In 2010, in line with a modest recovery of external demand, the forecast expects the economy to return to growth. This growth, however, is expected to be only 1% on average, although it will gradually pick up pace as the year progresses.

Household consumption will be broadly flat over the next two years, mainly on account of slowing real disposable income growth due to lower wage growth and declining employment, together with negative expectations of households. Consumer spending will start to recover gradually in 2010 H2. Household consumption will grow only slightly this year. In 2010 its growth will be zero.

The financial and economic crisis will have a large effect on gross capital formation, which will decrease this year owing to weak external demand and increased costs of investment financing. The unfavourable evolution of investment this year is also indicated by the latest available data on stagnating imports for investment and intermediate consumption. Investment growth will recover only at the end of 2010, in connection with a renewed recovery abroad. Total investment will thus drop by about 5% this year and show zero growth in 2010.

Real exports will be hit hardest by the world crisis (see Table III.3). The effect of unfavourable trends abroad on domestic exports will be partly offset by rising price competitiveness of Czech exporters thanks to a weaker exchange rate of the koruna. Even so, real exports will decrease by almost 2% this year. As Western Europe gradually recovers, export growth will increase again to 4% in 2010. As a result of the high import intensity of exports, import growth broadly follows the growth in exports. A decline in import growth this year will also be fostered by falling investment and flat household consumption. The contribution of net exports to real GDP growth will fall sharply to 0.5 percentage point in 2009 and 0.8 percentage point in 2010.

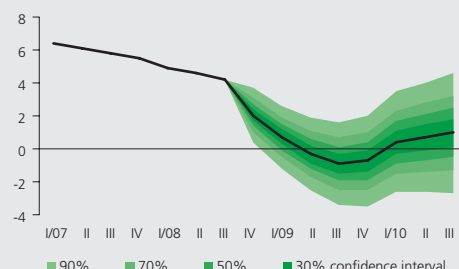
Government consumption will be the only component of domestic demand to maintain growth in the next two years. However, government consumption accounts for only a small part of demand and its contribution to growth will thus be low.

On the labour market, the slower economic growth will be accompanied by a sharp fall in nominal wage growth, a decline in employment and an increase in unemployment (see Table III.4). The downward pressures on wage growth will stem mainly from high labour costs in relation to labour productivity and also from a considerable slowdown in real economic activity. Wages will be greatly affected by lower bonuses as well as by a shorter working week as some firms cut production. The average nominal wage in the economy will thus grow at roughly 4% this year and less than 3% in 2010. In 2009, higher wage growth will be recorded in the non-business sector, whereas in previous years wage growth was higher in the business sector.

**CHART III.5 THE GDP GROWTH FORECAST**

**A slight decline in economic activity will occur in 2009**

(annual percentage changes; seasonally adjusted)



**TABLE III.3 FORECAST OF KEY GDP COMPONENTS**

**All components of demand will be subdued**

(annual percentage changes; seasonally adjusted)

|                                                                      | 2008  | 2009  | 2010  |
|----------------------------------------------------------------------|-------|-------|-------|
| GROSS DOMESTIC PRODUCT                                               | 3.9   | -0.3  | 0.9   |
| Household consumption                                                | 2.8   | 0.2   | 0.0   |
| Government consumption                                               | 2.0   | 1.5   | 0.8   |
| Gross capital formation                                              | -1.4  | -4.9  | -0.1  |
| Imports of goods and services                                        | 5.8   | -2.6  | 3.2   |
| Exports of goods and services                                        | 8.6   | -1.8  | 4.1   |
| Net exports of goods and services<br>(in CZK bn; at constant prices) | 116.4 | 140.6 | 172.6 |

**TABLE III.4 FORECAST OF SELECTED VARIABLES**

**The labour market will be affected by the economic slowdown**

(annual percentage changes)

|                                                    | 2008 | 2009 | 2010 |
|----------------------------------------------------|------|------|------|
| Real gross disposable income of households         | 2.6  | 2.2  | 0.4  |
| Total employment                                   | 1.6  | -0.9 | -1.9 |
| Unemployment rate (in per cent) <sup>a)</sup>      | 4.4  | 5.0  | 6.4  |
| Labour productivity                                | 2.0  | 0.7  | 2.9  |
| Average nominal wage                               | 8.2  | 4.0  | 2.7  |
| Average nominal wage in business sector            | 9.5  | 3.4  | 2.8  |
| Current account deficit (ratio to GDP in per cent) | -3.1 | -2.0 | -1.0 |
| M2                                                 | 8.3  | 5.5  | 3.5  |

a) ILO methodology



## III.3 FORECASTS BY OTHER ENTITIES

Financial market analysts' predictions were significantly affected by the global financial crisis and the related economic downturn. At the start of 2009, the analysts were expecting a decline in inflation, lower GDP growth and appreciation of the koruna's exchange rate at the one-year horizon. They were also expecting interest rates to fall.

TABLE III.5 INFLATION EXPECTATIONS

## Inflation expectations declined

(annual percentage changes of consumer price index)

|                              | 12/07 | 10/08 | 11/08 | 12/08 | 1/09 |
|------------------------------|-------|-------|-------|-------|------|
| Financial market, 1Y horizon | 4.5   | 2.5   | 2.4   | 2.2   | 2.1  |
| Financial market, 3Y horizon | 2.7   | 2.5   | 2.5   | 2.5   | 2.4  |
| Corporations, 1Y horizon     | 4.9   |       |       | 2.9   |      |
| Corporations, 3Y horizon     | 3.8   |       |       | 3.0   |      |

Inflation expected both by financial market analysts and by business managers declined at the one-year horizon (see Table III.5). Despite that, it exceeded the 2% inflation target valid from January 2010.<sup>32</sup> The analysts' predictions reflected the expected anti-inflationary real economy, decline in commodity prices (especially oil prices) and lower wage growth. Inflation expectations also declined in both sets of respondents at the three-year horizon, but they, too, were above the CNB's inflation target.

TABLE III.6 OTHER EXPECTED INDICATORS

## The financial market was expecting a sharp downswing in GDP growth

(at 1Y unless otherwise indicated)

|                                     | 12/07 | 10/08 | 11/08 | 12/08 | 1/09 |
|-------------------------------------|-------|-------|-------|-------|------|
| Real GDP in 2008 <sup>a)</sup>      | 4.7   | 4.2   | 4.2   | 4.2   |      |
| Real GDP in 2009 <sup>a)</sup>      |       | 3.2   | 2.4   | 1.4   | 0.5  |
| Nom. wages in 2008 <sup>a)</sup>    | 7.9   | 8.8   | 8.4   | 8.1   |      |
| Nom. wages in 2009 <sup>a)</sup>    |       | 6.7   | 6.1   | 4.7   | 4.0  |
| CZK/EUR exchange rate <sup>b)</sup> | 26.2  | 24.7  | 25.0  | 25.4  | 25.3 |
| 2W repo rate <sup>c)</sup>          | 3.8   | 2.9   | 2.1   | 1.9   | 1.6  |
| 1Y PRIBOR <sup>c)</sup>             | 4.1   | 3.5   | 3.0   | 2.8   | 2.5  |

a) year-on-year changes in per cent

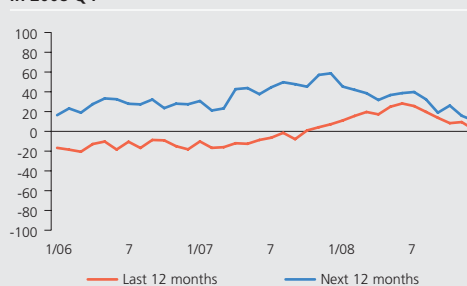
b) level

c) in per cent

Growth expectations declined substantially as regards the outlook for the other macroeconomic variables monitored (see Table III.6). Over the past few months, financial market analysts have gradually been reducing their GDP growth estimates owing to the worse economic outlook abroad. The slowing growth of the real economy is expected to lead to a higher unemployment rate and lower wage growth. Compared to the end of January 2009, the analysts expect a stronger exchange rate of the koruna at the one-year horizon, with the risks tending more toward depreciation. These risks depend mainly on the future state of the domestic economy and on liquidity in the foreign exchange market. The analysts were expecting the CNB's key rates to come down at the February meeting of the CNB Bank Board. The interest rate outlook also declined at all maturities compared to the previous quarter.

CHART III.6 PERCEIVED AND EXPECTED INFLATION

## Inflation expected by households decreased further in 2008 Q4



Source: European Commission Business and Consumer Survey

Compared to the current CNB forecast, the financial market analysts expect GDP growth to slow less significantly, amid slightly higher nominal wage growth. This is also reflected in slightly higher inflation expected by the analysts at the one-year horizon. The analysts' predictions for the exchange rate are broadly the same as the CNB forecast. The analysts' expectations regarding the 2W repo rate in 2009 Q1 are roughly in line with the interest rate path consistent with the CNB forecast described in section III.2. The rates expected at the one-year horizon are lower than those implied by the forecast-consistent rate path.

The indicator of inflation perceived by households remained positive in Q4, but continued to decline (see Chart III.8).<sup>33</sup> This means that households on average felt that prices tended to rise over the last 12 months; however, the number of households perceiving positive inflation declined. The indicator of expected inflation also decreased, but it, too, was positive. This suggests that the number of respondents who expect prices to increase more rapidly over the next 12 months than in the past is only slightly higher than the number of those who expect prices to stay the same.

<sup>32</sup> The CNB monitors the expectations of financial market analysts regarding key macroeconomic indicators and the inflation expectations of business managers by means of statistical surveys. Tables III.5 and III.6 show the average values from these surveys.

<sup>33</sup> The CNB draws on the 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).





## **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 16 December 2008

### **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 European System of Central Banks, EU Member States are required to achieve a high degree of sustainable convergence in order to join the euro area.

As regards European structures, 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. Failure to meet this criterion resulted in the Czech Republic being in the excessive deficit procedure from 2004 to June 2008.

#### **1.1 Assessment of Fulfilment of the Convergence Criteria**

The Czech Republic will evidently not fulfil **the criterion on price stability** in 2008. Inflationary shocks in particular have shifted inflation significantly, albeit temporarily, above the criterion value. These shocks included above all changes to indirect taxes, connected with the reform of public finances and also with harmonisation with EU law (a rise in the lower VAT rate, excise duty on cigarettes and the introduction of environmental taxes), as well as extreme growth in global food and energy prices. After these one-off effects subside, inflation will fall significantly in 2009 to values allowing fulfilment of the price stability criterion. Turning to the outlook for fulfilling this criterion in subsequent years, 2010 can be considered potentially risky owing to uncertainties regarding the contribution of administrative measures (the rate of increase of regulated rents).

The reduction of the CNB's inflation target for the national consumer price index (CPI) to 2.0%, with a tolerance band of  $\pm 1.0$  p.p., from 1 January 2010 creates better conditions for the fulfilment of the price stability criterion beyond this horizon. It is desirable, however, that no substantial inflationary changes to indirect taxes or other administrative measures in the consumer price area hindering the fulfilment of the criterion be made during the reference period for the assessment of this criterion.

The Czech Republic is compliant with **the criterion on the sustainability of the government financial position**. The government's fiscal strategy, which forms the basis of the updated Convergence Programme of the Czech Republic, should ensure that the government deficit is maintained below 3% of GDP. The structural deficit should fluctuate around 1.5% of GDP in 2008 and 2009, which should ensure that the government deficit will not exceed 3% of GDP even in the event of the expected economic slowdown.

The public debt-to-GDP ratio is well below the threshold. It should fall systematically in the medium run owing to a decrease in the government deficit and thanks to the use of expected privatisation revenues for non-debt financing of the deficit. However, not even a successful medium-term fiscal consolidation will be able to stabilise the government debt-to-GDP ratio in a sustainable manner if the fiscal system is not prepared for the expected adverse effects of population ageing. Unless the necessary reforms of the pension and health care systems are implemented, a gradual increase in the debt-to-GDP ratio is to be expected in the long term.

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. Moreover, the definition of the criterion is such that its interpretation is not entirely clear and so the assessment of its fulfilment cannot be clear either. The koruna has been showing an appreciation trend for some time, but – except in 2007 and 2008 – this has not resulted in an overall appreciation exceeding 15% during two consecutive years. However, given highly unfavourable external factors such as the currently escalating financial market crisis, sizeable fluctuations towards the weaker side of the hypothetical band of +15% cannot be ruled out either. Consequently, one cannot say for sure whether such a situation would be assessed as being compliant with the condition of movement close to the central parity "without severe tensions". It is impossible to estimate the depth, scope and duration of the current financial market crisis. In this situation, one cannot even estimate how long the period of increased exchange rate volatility, with potential koruna fluctuations in both directions, will last. Fulfilling the exchange rate criterion after joining ERM II could thus be very difficult under these conditions.

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

Owing to high economic growth, the Czech economy has gradually been catching up with the average GDP level of the euro area in recent years. The functioning of the Czech economy has recently seen some improvement, partly due to cyclical developments. The public finance deficit was reduced quite substantially in 2007. However, eliminating the structural deficit and ensuring public finance sustainability are still a challenge. On the labour market, some structural improvement is being observed in addition to the cyclical improvement. The business environment is also gradually improving. However, problems persist in the institutional framework on the labour market. The current financial crisis and its impacts pose a risk to the outlook for the economic alignment and overall performance of the Czech economy.

In the longer term, i.e. since 2003, when the Czech Republic's Euro-area Accession Strategy was adopted, there have been both favourable and unfavourable developments in terms of euro adoption and the flexibility of the Czech economy. The aforementioned positive shift in some indicators since 2006 came after a relatively adverse period during 2004–2006 which saw a deterioration in economic

alignment with the euro area and potential sources of asymmetric development and in the economy's ability to adjust to economic shocks. The Czech Republic's preparedness for euro adoption is thus roughly at the 2003 level for many indicators. Compared to 2003, in addition to advancing real and nominal convergence, there have been positive shifts in the fiscal outlook – even though there is a persisting need to reduce the structural deficit and to ensure long-term sustainability of public finances – and in the unemployment rate. By contrast, the global financial crisis is fostering higher macroeconomic risk.

In terms of its current preparedness to adopt the euro, the characteristics of the Czech economy can be divided into four groups.

**The economic indicators that speak in favour of the Czech Republic adopting the euro** traditionally include 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.

The second group comprises **areas which, in terms of euro adoption in the Czech Republic, continue to pose a risk of macroeconomic costs, but which have shown noticeable improvements in recent years**. The positive developments include continuing fast real economic convergence in the Czech Republic, including further convergence of the price level towards that in the euro area, even though a difference in the price level and in the level of economic development persists. According to some analyses, the alignment of economic activity between the Czech Republic and the euro area appears to have slightly increased recently. Owing to favourable cyclical developments and partly also to gradual structural changes, some improvements can be observed on the labour market, manifesting themselves, among other things, in a decline in total and long-term unemployment and a halt in the decline in the rate of economic activity of the population. International labour mobility has also increased, particularly as regards the inflow of foreign workers to the Czech Republic. However, this suggests persisting rigidities concerning the system of incentives for employing low-skilled Czech workers. In terms of labour market flexibility, the positive developments also include a halt in the growth in overall labour taxation, as well as a halt in the growth of the minimum wage ratio to the average wage. The conditions for entrepreneurship are also improving slowly. The public finance deficit has been reduced, its outlook for subsequent years decreased and the excessive deficit procedure against the Czech Republic has been abrogated; these are vital steps in terms of the country's preparedness to adopt the euro. A reduction in the structural deficit has created space for automatic stabilisers to work without any acute risk of the 3% limit for the government deficit being exceeded.

The third group contains **areas which traditionally represent bottlenecks as regards the economy's flexibility and ability to adjust to shocks and which, moreover, are not showing any significant improvements**. The stabilising effect of public finances continues to be limited by the existence of a structural deficit and by the relatively low effectiveness of automatic stabilisers. In the long run, it will also be necessary to ensure that demographic changes do not adversely affect fiscal policy effectiveness and the long-term sustainability of public budgets. The tax and benefit system, which, despite the measures adopted, still creates a demotivating environment for the long-term unemployed in low-income families with children, is a bottleneck on the labour market. According to analyses, wages in the Czech Republic do not seem to be responding flexibly enough to economic developments. 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 open-ended employment contracts, particularly after a short period of employment, remain very high by international comparison.

**The area of financial integration, where a satisfactory situation prevailed in the past, can be identified as the fourth group. Amid the current global financial crisis, the existence of an independent monetary policy has both benefits and costs; in general, however, it is likely that having one's own currency is more of a benefit in such a situation. The financial crisis can also be viewed as a temporary adverse factor as regards future adoption of the euro.**

From the point of view of the indicators monitored, the financial crisis has brought a slight reduction in the alignment of the exchange rate of the koruna with the euro and in the alignment with the euro area of yields on individual financial market instruments. The financial crisis can also be regarded as an example of an asymmetric shock, having various effects on individual economies depending on whether their financial sectors have suffered direct losses from investing in risky assets or whether these economies are facing only indirect impacts of the crisis. The continuing major uncertainty on financial markets does not constitute a favourable environment for the Czech Republic's entry into ERM II, even though the Czech Republic is not among the countries that have been hit directly by the crisis. As a system of fixed but adjustable exchange rates, ERM II is vulnerable to changes in financial market sentiment and in short-term capital flows. Any unfavourable developments during the Czech koruna's stay in this mechanism could generate macroeconomic costs and reduce the Czech economy's alignment with the euro area. As the financial crisis abates, we can expect the results in the area of the Czech economy's financial integration with the euro area to improve again and more favourable conditions for ERM II entry to be established. However, the financial crisis could also have longer-term adverse consequences for the alignment of individual Member States' economies if fiscal discipline in the EU is relaxed as a result. However, there is widespread uncertainty regarding the future application of the Stability and Growth Pact rules at the moment.

### 1.3 Conclusions and Recommendations

The government financial position is no longer the main barrier to the fulfilment of the Maastricht convergence criteria now that the excessive deficit procedure against the Czech Republic has been terminated. As the one-off inflationary effects that generated a temporary pronounced increase in inflation in 2008 subside, there will be a marked fall in inflation in 2009 to values allowing fulfilment of the price stability criterion. This will be aided by the CNB's new inflation target which takes effect in 2010. The criterion on long-term interest rates is being – and very probably will continue to be – fulfilled without any problems. The Czech Republic does not fulfil the exchange rate criterion because it does not participate in ERM II. The present global financial crisis is, among other things, increasing the volatility of the koruna's exchange rate, and so fulfilment of the exchange rate criterion after the country potentially joins ERM II could thus be very difficult under these conditions.

Turning to economic alignment, the Czech Republic has gradually been decreasing the gap in its economic level vis-à-vis the euro area in recent years, and the functioning of the Czech economy is showing some improvement. Despite a substantial reduction in the public finance deficit in 2007, eliminating the structural deficit and ensuring long-term public finance sustainability are still a challenge. On the labour market, some structural improvement is being observed in addition to the cyclical improvement. Some aspects of the business environment are also gradually improving. However, problems persist in the institutional framework on the labour market. The current global financial crisis can be viewed as a temporary adverse factor as regards future adoption of the euro, since it is acting as an asymmetric shock affecting the individual euro area countries to differing degrees. Moreover, the continuing major uncertainty on financial markets does not constitute a favourable environment for joining ERM II, since ERM II is potentially vulnerable to changes in financial market sentiment and in short-term capital flows. Any adverse developments during the Czech

koruna's stay in this mechanism could generate macroeconomic costs and reduce the Czech economy's alignment with the euro area. The financial crisis could also have longer-term adverse consequences for the alignment of individual Member States' economies if fiscal discipline in the EU is relaxed as a result.

In the context of the current global financial crisis, the outlook for fulfilling the Maastricht convergence criteria and, in particular, for maintaining and further increasing the degree of alignment of the Czech economy with the euro area is highly uncertain. **In this situation, therefore, it is impossible to conclude that the Czech Republic has made sufficient progress in laying the groundwork for euro adoption to allow it to set a target date for entry into the euro area. Therefore, in line with the Czech Republic's Updated Euro-area Accession Strategy (the "Strategy"), the Ministry of Finance and the Czech National Bank recommend that the Czech Government should not set the target date for the time being. The recommendation not to set a target date for euro area entry at the same time implies a recommendation that the Czech Republic should not attempt to enter ERM II during 2009.** 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. Potential ERM II entry under the current conditions of global financial crisis could, moreover, be considered relatively risky, not only from the point of view of fulfilling the exchange rate criterion, but also from the point of view of prudent economic policy generally.

## 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 1½ 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, given that these rates are 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 experience from the Convergence Reports published since 2004 has shown, both the Commission and the ECB have in these reports used the three countries with the lowest non-negative inflation, even though they have differed somewhat in their specific interpretations of the phrase “best performing Member States in terms of price stability”.

Moreover, the negative verdict for Lithuania<sup>1</sup> in the May 2006 Convergence Reports indicated that a very strict assessment can be expected as regards sustainable fulfilment of the criterion. If the outlook for the coming months foresees inflation rising above the reference value, the conclusion may be that the country is failing to satisfy the criterion in a sustainable manner. A similar signal has been sent out in the relatively strict assessment of the risks to the sustainable fulfilment of this criterion by Slovakia in the ECB Convergence Report 2008, despite the fact that Slovakia will ultimately enter the euro area in 2009.

According to the calculation of the reference value for the three countries with the lowest positive inflation (see Table 2.1), the Czech Republic did not fulfil this criterion in 2007 (when a sharp rise in world prices of food and oil occurred) and is even further from fulfilling it in 2008. The main exogenous factor was food prices, as a result of growing world prices, accompanied by an increase in the lower VAT rate from 5% to 9%. The introduction of environmental taxes and health care fees, further increases in excise duties and an extreme surge in oil prices acted in the same direction. Administrative measures (including changes in VAT and energy prices) will account for about 60% of total consumer price inflation this year.

**Table 2.1: Harmonised index of consumer prices**

(average for last 12 months vs. average for previous 12 months, growth in %)

|                                                  | 2005 | 2006 | 2007 | 08/08      | 2008       | 2009       | 2010       | 2011       |
|--------------------------------------------------|------|------|------|------------|------------|------------|------------|------------|
| Average for 3 EU countries with lowest inflation | 1.0  | 1.4  | 4.3  | 2.6        | 2.6        | 2.4        | 1.7        | 1.7        |
| Reference value                                  | 2.5  | 2.9  | 2.8  | <b>4.1</b> | <b>4.1</b> | <b>3.9</b> | <b>3.2</b> | <b>3.2</b> |
| Czech Republic                                   | 1.6  | 2.1  | 3.0  | <b>6.1</b> | <b>6.4</b> | <b>2.9</b> | <b>3.0</b> | <b>2.5</b> |

Sources: Eurostat, European Commission, Convergence Programmes and Stability Programmes of Member States (2007); the forecast for the Czech Republic is taken from the Convergence Programme of the Czech Republic (2008).

Note: The outlook for EU countries for 2008–2009 is taken from the European Commission's spring 2008 economic forecast.

<sup>1</sup> Lithuania recorded a significant rise in inflation between 2004 and 2006. As a result, inflation in Lithuania exceeded the price stability criterion reference value by 0.1 percentage point in the spring 2006 assessment.



Table 2.1 shows that while in 2009 and 2011 the Czech Republic should fulfil the price stability criterion comfortably if inflation expectations continue being well anchored, in 2010 it might fulfil this criterion by only a narrow margin. Uncertainty is associated, among other things, with the question of to what extent municipalities will take the opportunity to increase regulated rents by the maximum percentage (the estimated average increase may be as much as 50% year on year). Another uncertainty is the assumption of stable exogenous factors (world prices, exchange rates).

However, when assessing the future ability to maintain inflation below the reference value, one needs to take into account that the individual countries' inflation forecasts, with few exceptions, do not deviate far from the ECB's inflation objective, whereas actual inflation deviates from it significantly more. 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 tended to be 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 more probably be found.

By contrast, a greater degree of certainty of future fulfilment of the criterion will be fostered by the CNB's new inflation target of 2.0% for the national CPI, with a tolerance band of  $\pm 1.0$  percentage point, from 1 January 2010.<sup>2</sup> It is desirable, however, that no substantial inflationary changes to indirect taxes or other administrative measures in the consumer price area be made during the reference period for the assessment of this criterion (i.e. ERM II participation). Such measures would hinder fulfilment of the criterion.

## 2.2 Criterion on the Sustainability of Public Finances<sup>3</sup>

### 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 was given a deadline of the end of 2008 to bring its government deficit below 3% of GDP in a credible and sustainable manner. The favourable fiscal result for 2007 led to the abrogation of the procedure in June 2008.

#### **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

<sup>2</sup> In its Inflation Report IV/2008, the CNB forecasts lower inflation for 2008–2010 than given in the Czech Republic's aforementioned 2008 Convergence Programme.

<sup>3</sup> 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.

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, or
  - 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

The current settings of the Czech Republic's public finance parameters enable it to satisfy the government deficit criterion in the medium term. Provided that the approved expenditure frameworks are complied with, the government's fiscal strategy should ensure that the government deficit remains safely below 3% of GDP (see Table 2.2).

**Table 2.2: General government balance**

(ESA 1995 methodology, in % of GDP)

|                 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|-----------------|------|------|------|------|------|------|------|
| Reference value | -3.0 | -3.0 | -3.0 | -3.0 | -3.0 | -3.0 | -3.0 |
| Czech Republic  | -3.6 | -2.7 | -1.0 | -1.2 | -1.6 | -1.5 | -1.2 |

Sources: CZSO, *Government Deficit and Government Debt Notifications* (October 2008), *Convergence Programme of the Czech Republic* (November 2008).

The medium-term budgetary objective for the Czech Republic under the Stability and Growth Pact is to achieve a structural general government deficit of 1% of GDP. The current strategy for reducing the structural general government deficit assumes that this objective will be achieved by 2012.

The structural deficit should be around 1.5% of GDP in 2008 and 2009 and decline gradually in the years that follow. This structural deficit level provides a certain margin of safety against exceeding the 3% threshold in the event of a somewhat sharper-than-expected economic slowdown in the Czech Republic.

Greater involvement of reserve funds in government expenditure, with a negative impact on the deficit, remains another risk to the fiscal outlook in the years ahead.<sup>4</sup> The adoption of a law to rectify some property injustices against churches and/or a one-off solution to environmental obligations could also widen the deficit. The potential impacts on public finances will depend on the exact form of the relevant measures.

<sup>4</sup> A total of CZK 96.9 billion (2.7% of GDP in 2007) had been accumulated in the reserve funds by the end of 2007. Of this, around CZK 40.7 billion (1.2% of GDP in 2007) are funds that would widen the government deficit if included in expenditure. The remaining funds are to be used for the pre-funding of projects co-financed by EU funds and will thus be refunded from the EU budget once the projects are implemented.

### Government debt criterion

Given the low initial level of government debt, the Czech Republic has no problem fulfilling this criterion. The sharp rise in government debt in 2001–2003 largely reflected the inclusion of the majority of the government's indirect liabilities identified (primarily government guarantees and the classification of Česká inkasní, the Czech Consolidation Agency and their subsidiaries in the general government sector). More recently, the public debt-to-GDP ratio has gradually been reduced thanks to fast economic growth and a decline in the government deficit.

This ratio should decline further in the medium term owing to a decline in the deficit below the level stabilising the debt-to-GDP ratio and the expected use of privatisation revenues for non-debt financing of government expenditure (see Table 2.3).

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

|                 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|-----------------|------|------|------|------|------|------|------|
| Reference value | 60.0 | 60.0 | 60.0 | 60.0 | 60.0 | 60.0 | 60.0 |
| Czech Republic  | 29.8 | 29.6 | 28.9 | 28.8 | 27.9 | 26.8 | 25.5 |

Source: CZSO, Government Deficit and Government Debt Notifications (October 2008), Convergence Programme of the Czech Republic (November 2008).

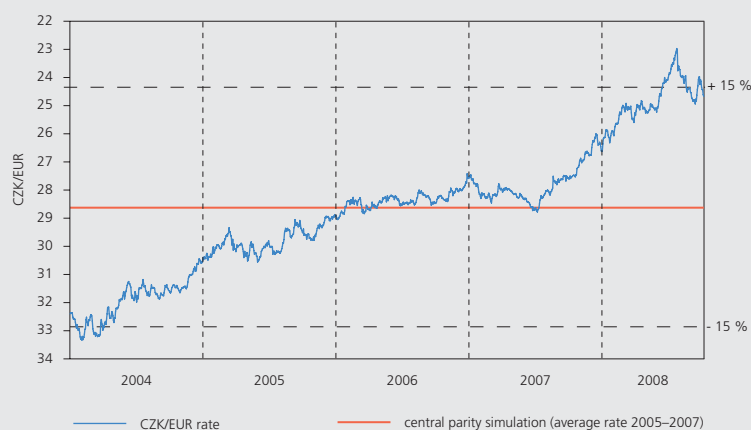
However, not even a successful medium-term fiscal consolidation guarantees the stabilisation of the government debt-to-GDP ratio in a sustainable manner if the fiscal system is not prepared for the expected adverse effects of population ageing. Unless the necessary reforms are implemented to mitigate the fiscal impacts of population ageing, in particular a pension system reform and health care reform, a gradual increase in the debt-to-GDP ratio is to be expected in the long term.

### 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 exchange rates for 2005–2007.

The koruna's exchange rate has been recording a long-term appreciation trend. The exchange rate fluctuated within the hypothetical band until 2007. The trend appreciation took place amid relatively low short-term volatility and at such a pace that the exchange rate did not appreciate by more than 15% in total during two consecutive years. However, the developments in 2008 showed that deviations from the average rate can be enormous and that a 15% appreciation can be achieved in much shorter times given some combination of external and domestic factors. In the current financial market crisis, moreover, the fluctuations in the CZK/EUR exchange rate may go in either direction.

Chart 2.1: Nominal CZK/EUR rate



Source: CNB, Ministry of Finance calculations

Note: In the chart, an upward movement of the exchange rate means an appreciation of the koruna.  
The hypothetical central parity is simulated by the average exchange rate for 2005–2007.

The definition of the criterion is such 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 other factors than the exchange rate level alone (see Box 2.3). However, the assessment is not unambiguous even in the light of this statement. Consequently, one cannot say for sure whether the present situation would be assessed as being compliant with the condition of movement close to the central parity “without severe tensions”.

### BOX 2.3: Definition of the criterion on exchange rate stability

#### Treaty provisions

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

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

#### Application of Treaty provisions 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 States 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  $\pm 2.25\%$  around bilateral central parities, whereas a  $\pm 6\%$  band was a derogation from the rule. In August 1993 the decision was taken to widen the fluctuations margins to  $\pm 15\%$ . 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.

The example of the assessment of sustainability of fulfilment of the exchange rate stability criterion for Slovakia in the 2008 ECB Convergence Report recalls that some European authorities currently tend to take a stricter view in the interpretation of the convergence criteria and their fulfilment.

Successful ERM II participation may be aided in particular by alignment with the euro area economy and consistency of economic policies. The Czech Republic’s 2003 Euro-area Accession Strategy and its 2007 update recommend 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”.<sup>5</sup>

<sup>5</sup> 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.xml/eu\\_acc\\_stra.html](http://www.mfcr.cz/cps/rde/xchg/mfcr/hs.xml/eu_acc_stra.html).

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 will be setting an appropriate and sustainable central parity.

Given the currently spreading financial market crisis, which is causing larger exchange rate fluctuations, this criterion might be very difficult to fulfil after ERM II entry.

## 2.4 Criterion on Long-term Interest Rates

### BOX 2.4: Definition of the criterion on long-term interest rates

#### Treaty provisions

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

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

#### Application of Treaty provisions 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 comfortably compliant with the criterion on long-term interest rates and no problems are expected in this area in the future<sup>6</sup> (see Table 2.4). The decline in the criterion level in 2010 and 2011 is due to a technical assumption

<sup>6</sup> 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 2009–2011 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.



of real interest rate stability, and thus also of stable financial market sentiment. Given the previous and expected developments in this area, it cannot be ruled out that the real level of this criterion will be higher.

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

|                                                  | 2005 | 2006 | 2007 | 08/08      | 2008       | 2009       | 2010       | 2011       |
|--------------------------------------------------|------|------|------|------------|------------|------------|------------|------------|
| Average for 3 EU countries with lowest inflation | 3.4  | 4.2  | 4.4  | 4.4        | 4.6        | 3.9        | 3.2        | 3.2        |
| Reference value                                  | 5.4  | 6.2  | 6.4  | <b>6.4</b> | <b>6.6</b> | <b>5.9</b> | <b>5.2</b> | <b>5.2</b> |
| Czech Republic                                   | 3.5  | 3.8  | 4.3  | <b>4.7</b> | <b>4.7</b> | <b>4.4</b> | <b>4.3</b> | <b>4.2</b> |

Source: Eurostat, Convergence Programmes and Stability Programmes of Member States (2007), Convergence Programme of the Czech Republic (November 2008).

The forecast for interest rates on government bonds in the Czech Republic is dependent on the sound development of public finances. Any decline in financial market confidence in the positive fiscal outlook could lead to a rise in the risk premium on long-term interest rates and make this convergence criterion more difficult to fulfil.

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

This part summarises the results of a set of analyses directed at assessing the Czech economy's alignment with the euro area over and above the formal criteria, the fulfilment of which is assessed in the previous part. If the Czech economy is to reap the benefits associated with introducing the euro it will need to be able to operate without an independent monetary policy and without the option of exchange rate adjustment vis-à-vis its most important trading partners. This ability will be affected by the similarity of economic developments in the Czech economy with those in the euro area, since the degree of alignment will co-determine the appropriateness of the monetary conditions in the euro area to the current situation in the Czech Republic. The ability to adjust rapidly to economic shocks will be also an important factor. The Czech economy's alignment and its preparedness to adopt the euro can thus be assessed in terms of the long-term economic trends, the medium-term development of economic activity and the structural similarity of the Czech economy to the euro area economy, all of which affect the probability of asymmetric developments and the occurrence of asymmetric shocks, and in terms of the ability of the economy to absorb shocks and adjust flexibly to them.

The analyses are divided into two basic groups according to 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 of 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 alignment indicators over time and in comparison with selected countries. The countries under comparison either are euro area members already (Austria, Germany, Portugal and Slovenia)<sup>7</sup> or will become so in the near future (Slovakia) or aspire to such membership (Poland and Hungary). The individual studies were prepared using the statistical data and information available in September 2008. 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

<sup>7</sup> 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. The values of the indicators for the euro area are defined at the EA-13 level.

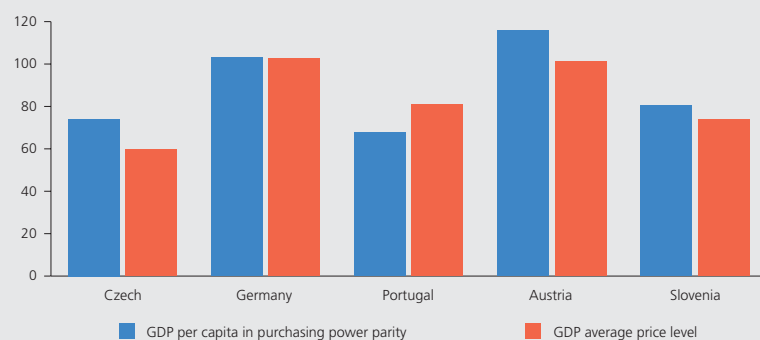
and the assessment of developments over time. In general, it can be expected that the benefits of adopting the euro will grow with greater economic alignment and stronger adjustment mechanisms.

### 3.1 Cyclical and Structural Alignment

The costs arising from the loss of the Czech Republic's own monetary policy will be particularly 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.

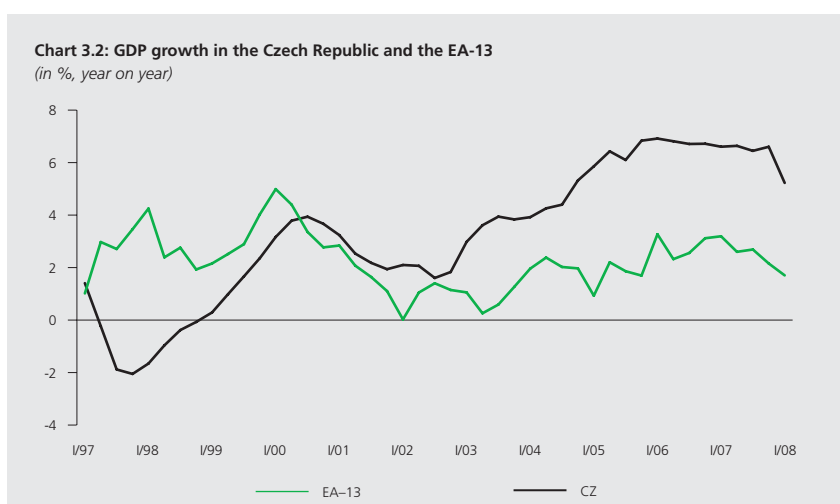
**The degree of real economic convergence** is an important indicator of the Czech economy's similarity to the euro area. A higher level of such convergence fosters greater similarity of long-run equilibrium development. Indirectly it can also foster a lower likelihood of misalignment in the shorter run. A higher degree of convergence in the economic level prior to ERM II entry and euro adoption should further 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. The process of convergence of the GDP and price levels has accelerated over the past five years. At present, GDP per capita in the Czech Republic is almost 75% of the euro area average, which means that the standard of living is comparable with the less advanced members of the euro area (see Chart 3.1). However, at 60% of the euro area level in 2007, the price level in the Czech Republic is still below that corresponding to its economic level. This indicator shifted upwards in 2004–2007, mainly due to rapid nominal appreciation of the koruna, and the same factor will underlie the likely further significant convergence in 2008. The real exchange rate of the koruna appreciated at an average pace of 3.2% a year between 1998 and 2007, which is a significantly higher pace than in the current euro area countries under comparison. The pace of real appreciation increased even more significantly in 2008. Going forward, the equilibrium trend of real appreciation of the koruna against the euro can be expected to continue in line with the real convergence, according to the analyses at a rate of 1.3%–2.4% a year. Persistence of this trend following the euro area entry will initially engender a corresponding higher rate of inflation in the Czech Republic than in the euro area and related lower domestic real interest rates (possibly 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 associated with adverse consequences for macroeconomic and financial stability.

**Chart 3.1: Real economic convergence of selected countries towards the euro area in 2007**  
(EA-13 average = 100)



Source: Eurostat, CNB calculations.

**Alignment of economic activity and similarity of economic shocks** will help the single monetary policy to have an appropriate effect on the economy in the monetary union. The analyses suggest that the overall economic activity during the business cycle in the Czech Republic is becoming more aligned with 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 developments in the Czech economy. Although the observed correlations are lower than those of the euro area countries under review, they are slightly higher than those for the currently acceding Slovakia, for example. However, the analysis of the occurrence of demand-side and supply-side macroeconomic shocks failed to find any alignment of the Czech economy with that of the euro area. By contrast, a relatively high degree of alignment with the euro area is signalled by some other indicators, for example by the alignment of activity in industry and export activity. According to the analyses, the Czech Republic's export activity has recently been statistically significantly correlated with euro area exports rather than with GDP growth in the euro area. This may be linked with the integration of Czech exporters into the production chains of multinational companies, and creates conditions for relatively symmetrical transmission of external shocks hitting the euro area to the Czech economy.



Source: Eurostat, CNB calculations.

Similarity of the **structure of economic activity** with the euro area should decrease the risk of occurrence of asymmetric economic shocks. In terms of production structure, 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. The high share of the **car industry** in Czech industrial production and exports and its cyclical nature are often viewed as a potential source of asymmetric developments. The share of the car industry in the total output and value added of the Czech economy is comparable to that of Germany, which means that it is higher than the euro area average. Therefore, although any sector-specific shock will affect numerous countries, the disproportionately high share of the car industry in economic output compared to the euro area average may mean that the single monetary policy, in the event of such a shock, will not respond to inflationary or anti-inflationary risks in the Czech economy in the same way as an independent monetary policy would. The relatively high energy intensity and almost complete dependence of the Czech economy on imports of oil are reasons for analysing the impacts of a potential **oil price shock** on the Czech economy. The adverse effect of an oil price shock will depend on the size of the changes in oil prices

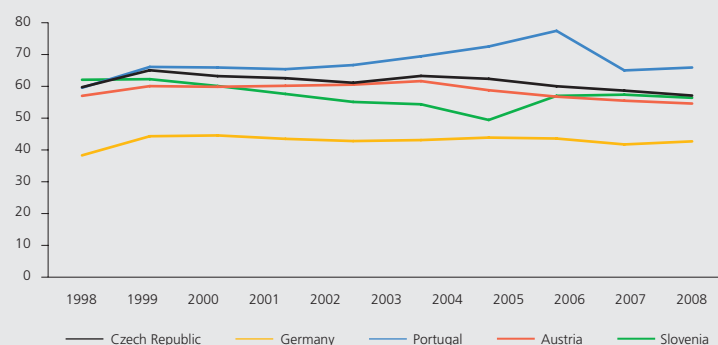
and their impacts on global demand and demand for Czech exports. Nevertheless, according to estimates in the available literature a relatively subdued impact can be expected, although the impact could be somewhat higher than that on the euro area, mainly because of the higher energy intensity of the Czech economy.

Fast convergence of **nominal interest rates** in the run-up to joining the euro area has acted as an asymmetric shock in some economies in the past. For a country planning to enter, earlier gradual convergence of such rates is therefore an advantage. The difference between Czech interest rates and euro area interest rates has been zero or negative since 2002. A positive interest rate differential opened up temporarily for five-year rates in 2008 H1, although this was probably associated with the impacts of the emerging credit and liquidity crisis in the USA. Provided that no major changes occur, 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 had been moving very much in line with the euro's exchange rate against the dollar in past years. In 2007 and 2008, however, this relationship loosened, mainly because of the financial crisis and the related increased volatility of exchange rates. The observed medium-term volatility of the Czech koruna against the euro increased in 2008. The Hungarian forint and the Polish zloty showed a similar trend, while the volatility of the Slovak koruna decreased owing to the planned adoption of the euro in Slovakia.

Increased **inflow of resources from EU structural funds** could be a specific asymmetric factor that might impact on the Czech economy. Conditional on a sufficient absorption capacity of the economy this could act as a considerable economic stimulus, materialising primarily in increased investment activity. Although the net financial position of the Czech Republic vis-à-vis the European Union increased in 2007, the rise was due mainly to advance payments to Czech public budgets. The actual drawdown of funds and their economic use has been slow so far. By 2013, the net position will gradually increase to 1.8% of GDP, the highest annual rise being expected in 2009. However, the economic stimulus from these flows will depend on the actual extent of utilisation of these funds by final beneficiaries in the private and public sectors. The financial flows between the Czech Republic and the EU can also be expected to affect the Czech public budgets. The impact on public finances should be positive, provided that a proportion of the funds is re-directed from national projects. The analysis indicates that in 2008 a roughly neutral effect and from 2009 a slightly positive effect of drawdown of EU funds on the economic activity of the Czech Republic is to be expected. However, 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 assessment of the Maastricht exchange rate criterion.

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 (see Chart 3.3) and its share will increase to around 66% after Slovakia joins the euro area. Strong links are also apparent for the other economies under comparison. The Czech economy's ownership links with the euro area on the direct investment inflow side are slightly stronger than in the other countries under comparison, except for Slovakia, and are continuing to grow. The Czech economy's strong economic integration with the euro area creates conditions for increasing 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 only slightly lower than in Austria and Germany.

**Chart 3.3: Exports to the EA-13 as a percentage of total exports**  
(in %)



Source: IMF, CNB calculations.

The analysis of the Czech **financial sector**, and, within it, the banking sector, reveals that despite its relatively smaller size and depth of financial intermediation in comparison with the euro area, it need not be expected to have a fundamentally different effect on the economy at a time of normal economic development. The monitored indicators have in recent years recorded further slight convergence towards the euro area. The depth of financial intermediation in the Czech Republic is currently roughly one-third of that in Germany, Austria and the euro area and 42% of that in Portugal. The Czech Republic has lower volume of lending in particular. 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 implies convergence towards the corresponding ratios 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 and corporate debt. The historical experience of some countries with high long-term credit growth shows that at a time of crisis and economic slowdown, over-leveraging can cause extensive economic problems. Less prudent assessment of client creditworthiness and of the financial and economic outlook is often a source of credit risk growth and financial instability. The crisis on the global financial market and the related economic stagnation of the Czech Republic's major trading partner countries have so far spilled over into the Czech financial sector and domestic economy to only a limited extent, in the form of increased volatility of the koruna's exchange rate, slowing economic growth and a decline in prices of some assets. In the past, domestic financial institutions focused primarily on revenues from the dynamically expanding retail banking activities in the Czech market, while their owners generally concentrated the management of risky securities and derivatives portfolios in parent banks and branches in international financial centres. The stability of the domestic banking sector is aided by the banks' high balance sheet liquidity and solvency, the financing of loans mostly by primary deposits and hence minimum dependence on funds raised on foreign markets, and minimal investment in bonds backed by foreign subprime mortgages. Despite this, the effects of the crisis may, to a limited extent, directly affect some domestic financial institutions via their risky investments. However, the indirect effect through a worsening financial situation of households and corporations will be dominant. Owing to the financial crisis, the growth of the Czech Republic's major trading partner economies is slowing, which in turn is generating deteriorating export conditions. The ensuing slowdown in the domestic economy can potentially increase the loan default rate.

**The structure of the financial assets and liabilities of Czech non-financial corporations and households** maintains certain differences from that of euro area entities. The difference is particularly visible in a relatively high share of trade receivables in corporate assets and in the structure of households' liabilities. However, gradual convergence towards the structure in the euro area can be observed. The indebtedness of Czech corporations and households is currently significantly lower than in the euro area countries under review. The use of the euro in the financial transactions of non-financial corporations is gradually growing, reflecting the Czech economy's openness and foreign trade integration. However, the degree of spontaneous euroisation is still relatively low, although there is a difference between corporations and households. The expansion of foreign currency cash holdings and deposits of households in the Czech Republic is roughly comparable with the selected Central European countries, but foreign currency borrowing is very low.

The degree of **integration of the Czech financial markets** (money, foreign exchange, stock and bond) with the euro area markets is comparable or higher than that in Hungary, Poland and Slovakia. In comparison with Austria and Portugal, the integration of the stock market is similar, but that of the bond market is lower. The speed of elimination of shocks on the Czech stock market has increased since 2002, but, like on other markets, the speed of adjustment has recently declined somewhat as a result of the global financial market turbulence. 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. The comparison with Slovenia regarding the degree of foreign exchange market integration is not very relevant, as it had a different exchange rate regime. Owing to recent developments, the degree of integration is lower than that in Slovakia, which is to enter the euro area.

### 3.2 Adjustment Mechanisms

As regards **the public finances** of the Czech Republic, the effectiveness of the stabilisation function within the European fiscal rules will be crucial. Under the Stability and Growth Pact, the Czech Republic committed itself to steering towards a structural general government deficit of no more than 1% of GDP by 2012. The closer the deficit is to zero, or the larger the surplus, in its structural part, the more room there will be at a time of economic downturn for the functioning of automatic stabilisers and, in the extreme case, for the implementation of discretionary measures. So far, the Czech Republic's government sector deficits have been due primarily to structural factors. The effect of the business cycle started to be felt more strongly only in 2007 and 2008. Eliminating the adverse structural effects is an important condition for the use of the stabilising function of public budgets. Developments in 2007 and 2008 suggest a gradual improvement in the state of public finances. Another condition for maintaining fiscal policy effectiveness will be to ensure public finance long-term sustainability, in particular by addressing the effect of demographic changes on pension and health care system expenditures.

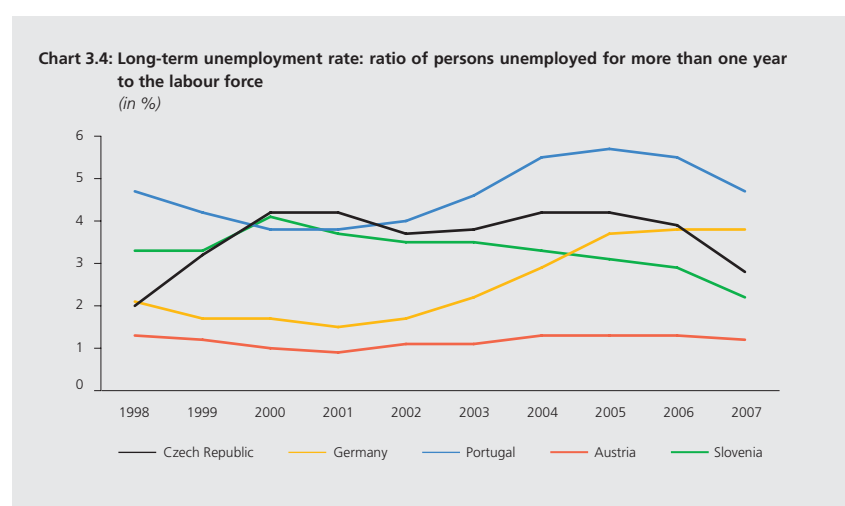
**Wage elasticity** can enhance the economy's ability to absorb shocks to which the single monetary policy cannot respond. The analyses indicate that real wage elasticity in the Czech Republic is currently low, just like in the other countries under comparison, and has not improved substantially over time. Differences in **inflation persistence** in the countries of the monetary union might lead to different impacts of the single monetary policy. Inflation persistence in the Czech Republic is among the lowest of the countries under comparison.

Thanks mainly to recent cyclical developments, the Czech **labour market** has recently been experiencing some improvements in its performance, as the overall and long-



term unemployment rates have declined (see Chart 3.4). Structural unemployment is also probably falling. The improving business environment may also be contributing indirectly to labour market flexibility. 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 after a short period of employment.

Despite some improvements, the Czech Republic still has the largest regional differences in the unemployment rate. This may be due to 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 the contribution of cross-border mobility of Czech citizens to the adjustment in the event of economic imbalances will be relatively limited, even after movement of labour between the Czech Republic and all the original EU countries has been fully liberalised by 2011. The inflow of foreign labour into the Czech Republic has been very dynamic since 2005, contributing to the 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 work among the long-term unemployed with low skills), since the foreigners work mainly in jobs requiring low qualifications. At the same time, the fact that movements of foreign workers can take place independently of labour demand and the business cycle in the Czech Republic poses a risk to labour supply.



Source: Eurostat.

Labour market flexibility is determined to a great extent by the **institutional rules**. Collective bargaining has a smaller effect on wage setting in the Czech Republic than in most of the countries under comparison. The impact of the minimum wage on the flexibility of low wages and on job creation is also rather low on average by international comparison. The halt in growth, or slight decline, 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 could have an adverse effect on labour market flexibility. Overall labour taxation in the Czech Republic increased slightly in 2007. The effect of taxation on long-term unemployment and job creation

was roughly the same as in Austria, Hungary and Poland, but higher than in Portugal 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. According to the simulations, the financial incentives to seek employment weakened for some groups of the population in 2007 because of the reform of the social benefit system. The level of social benefits coupled with the tax burden may diminish efforts to seek or keep a job, particularly of households with children. Although the 2008 reform has halted the adverse trends, it has not delivered a significant reduction of the existing problems. The Czech Republic is one of the countries with a relatively high degree of job protection in the area of permanent employment but relatively low protection of temporary employment, which may present a risk in particular as regards the entry of young people to the labour market.

In the area of **product market flexibility**, the regulatory environment for entrepreneurship is more burdened with administrative obstacles by international comparison. However, the situation is slowly improving. In particular, gradual steps are being taken to simplify the procedures for setting up a business and carrying on business activities. These measures are likely to have a positive effect on job creation as well. As in the other countries under comparison, the corporate taxation rate has been declining recently and is currently one of the lower ones, but the overall tax burden on Czech corporations is higher than in Austria, Portugal, Poland and Slovakia.

**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 banking sector has achieved a high level of efficiency and profitability in the European context, and in past years has accumulated a sufficient capital reserve from its profits. The percentage of non-performing loans in the Czech Republic has in recent years declined to a level only just above the euro area average. At a time of falling economic growth amid a continuing global financial crisis, a slowdown in lending and a deterioration of loan portfolios can be expected. This will adversely affect the capital adequacy and profitability of banks. Stress test results so far indicate that the Czech banking sector is sufficiently resilient to external shocks, although a strongly adverse macroeconomic scenario would naturally have a negative impact on the performance and stability of the banking sector.

**MINUTES OF THE BOARD MEETING ON 17 DECEMBER 2008**

Present at the meeting:

Z. Tůma (Governor), M. Hampl (Vice-Governor), M. Singer (Vice-Governor), R. Holman (Chief Executive Director), V. Tomšík (Chief Executive Director), E. Zamrazilová (Chief Executive Director)

The meeting opened with a presentation of the eighth situation report, supplemented with an analysis of statistical data published after the report had been finalised. Both the situation report and the assessment of the latest data implied a clear anti-inflationary balance of risks for the forecast. The main downside risks included the economic downturn abroad, the decline in global commodity prices, the lower-than-expected current inflation, slower domestic economic growth and also the evolution of client interest rates and rates on the interbank market. The weaker exchange rate of the koruna presented an upside risk to inflation.

After the presentation of the situation report, the Board discussed the newly available information and agreed that the balance of risks to the fulfilment of the current forecast was tilted significantly towards the downside. It was said in the discussion that the new information both from the domestic economy and from abroad was signalling different-than-expected developments. The current forecast was thus a much weaker guide for decision-making than usually. The need to stabilise inflation expectations while bearing in mind the risk of sharp disinflation was among the principal arguments for a more significant rate reduction.

The Board agreed that the external environment in particular was a source of sizeable anti-inflationary shocks. It was said that an unprecedented downward revision of the outlook for economic growth abroad was occurring. The fall in external demand was described as being a result of a typical excess capacity crisis, and that this excess capacity, moreover, was concentrated in key branches for the domestic manufacturing industry. The Board agreed that the high openness of the Czech economy meant that this adverse shock would transmit to it rapidly and strongly. There was also agreement that the current rapid decline in global commodity prices and the near-term outlook for those prices constituted an additional sizeable anti-inflationary shock. The opinion was also expressed that optimum monetary policy-making should be the priority, even at the cost of more difficult communication.

The incomplete and lagged pass-through of the changes in monetary policy rates to market rates and to client interest rates was discussed, as were the monetary policy implications of this phenomenon. The opinion was repeatedly expressed that in order to steer interest rates relevant to the economy in the desired way, the imperfect transmission of monetary policy rates had to be compensated for by making larger changes to monetary policy rates. Against this, however, it was said that although the pass-through was lagged and that market and client rates contained additional credit and other premia, most of the changes in the CNB's rates ultimately transmitted to interest rates relevant to the economy. It was also said that owing to the year-end it was unreasonable to expect any change in rates to have a major effect this year. Therefore, it might be useful, given the persisting uncertainty, to spread the monetary policy measures more over time.

Potential disturbances to financial intermediation by domestic banks were mentioned as another potential downside risk to inflation. Although domestic banks had sufficient capital, they might start to rein in their lending in response to the increased uncertainty and negative expectations linked with the world financial crisis and the downswing in the real economy.

In the context of the debate of monetary policy transmission mechanisms, attention was given to the effect of the exchange rate on the real economy and on inflation. The Board agreed that in the present situation the weaker exchange rate was having a stabilising effect on the domestic economy. The opinion was expressed that external demand was currently having a stronger effect on the domestic economy than the exchange rate. Against this, it was said that the exchange rate transmission channel was ensuring relatively rapid transmission of the monetary policy impulse to the economy.

The Board discussed the risks to the koruna exchange rate going forward. The uncertainty in this regard was generally an argument for a gradual adjustment of monetary policy rates. Regarding the effect of the interest rate differential on the exchange rate, the prevailing view was that the differential between koruna monetary policy rates and ECB rates was now playing only a very small role. In support of a greater reduction in rates, however, it was repeatedly said that a major widening of the differential in favour of the Czech currency – for example following a larger reduction in foreign rates – might foster a possible change in the exchange rate trend and a return to appreciation of the koruna. However, it was also said that the probability of a further weakening of the koruna seemed higher than the probability of a return to a stronger koruna. The opinion was also expressed, though, that the costs of the less likely appreciation would be asymmetrically high, and the Board's next regular monetary policy meeting was not due to take place until February, whereas a sizeable fall in foreign rates could be expected in the interim. Conversely, the arguments for a more cautious approach included concerns of triggering a precipitous weakening of the exchange rate as a possible consequence of a too-large change in domestic rates.

At the close of the meeting the Board decided by a majority vote to lower the CNB two-week repo rate by 0.50 percentage point to 2.25%, effective 18 December 2008. At the same time it decided to lower the discount rate and Lombard rate by the same amount, to 1.25% and 3.25% respectively. Four members voted in favour of this decision: Governor Tůma, Chief Executive Director Holman, Chief Executive Director Tomšík and Chief Executive Director Zamrazilová. Vice-Governor Hampl voted for lowering the repo rate by 0.75 percentage point and Vice-Governor Singer for lowering the rates by 1 percentage point.

**MINUTES OF THE BOARD MEETING ON 5 FEBRUARY 2009**

Present at the meeting:

Z. Tůma (Governor), M. Singer (Vice-Governor), R. Holman (Chief Executive Director),  
P. Řežábek (Chief Executive Director), V. Tomšík (Chief Executive Director),  
E. Zamrazilová (Chief Executive Director)

The meeting opened with a presentation of the first situation report containing the new macroeconomic forecast. Headline inflation had fallen significantly in 2008 Q4 and in December was within the tolerance band of the inflation target. The domestic economy was continuing to decline from the peak of the business cycle. This decline was faster than assumed by the previous forecast owing to a sharp downswing in external demand. Domestic inflationary pressures were subsiding rapidly, but the anti-inflationary pressures arising from the past appreciation of the exchange rate were also fading as a result of a depreciating exchange rate. The initial inflation pressures were assessed as being anti-inflationary, but their intensity had decreased owing to the weakening exchange rate.

According to the new forecast, inflation would fall this year and would approach zero in mid-2009. Inflation would come down thanks to the unwinding of the inflationary price shocks that had occurred in late 2007 and early 2008 and to a decline in prices of food and energy-producing materials. At the end of this year inflation would start rising, and in the first half of next year it would approach the new 2% inflation target valid from the beginning of 2010. As a result of the unwinding of the first-round effects of changes to indirect taxes, monetary-policy relevant inflation would coincide with the headline inflation forecast as from the second half of this year. The forecast expected a sharp slowdown in economic growth owing to the global financial and economic crisis. Zero or slightly negative growth was expected on average this year, and growth of around 1% was foreseen in 2010 due to a gradual recovery of external demand. The nominal exchange rate would initially correct its depreciation observed at the beginning of this year and would then be broadly stable. Consistent with the forecast was a decline in interest rates.

After the presentation of the situation report, the Board discussed the new forecast and the risks associated with it. The board members agreed that the appropriate response to the current situation was to lower rates. It was also said that the current rate reduction phase might now be at an end. Compared to the previous forecast there had been an exceptionally large revision of the outlook for the external environment in the anti-inflationary direction. In particular, growth and inflation in the euro area, foreign interest rates and prices of energy-producing materials were all lower. There was agreement that the risk of a deeper and longer-lasting global economic crisis was acting towards lower growth of the domestic economy. The main upside factor for inflation identified in the discussion of the risks of the forecast was a weaker exchange rate.

The Board agreed that the Czech economy, which is highly open, would be hard hit by the slump in external demand. The prevailing view was that the impact of the reduction in external demand on the Czech economy would be strong because of the high concentration of production in certain branches of manufacturing. A slump in production capacity utilisation would imply a need to adapt to the new market conditions in the Czech economy and abroad. It was said that the latest industrial production and foreign trade statistics suggested the risk of a deeper-than-forecasted decline in economic activity. It was repeatedly said that the sharp decline in demand would be reflected above all in decreasing investment and exports. In the context of the decline in demand, it was also said that corporations would react to the lower demand by cutting their labour costs. It was said that subdued growth in nominal wages would be only partly offset by low inflation, and in this context it was said that household consumption growth might be lower than forecasted. The Board agreed that government consumption would be the only component of economic growth to record positive growth over the entire forecast horizon. In the discussion of the risks to economic growth, it was said that monetary policy would not avert the approaching recession, but could influence the real economy next year.

In connection with the risk of lower economic growth, it was repeatedly said that the lower demand might be associated with higher anti-inflationary pressures. The concern was expressed that inflation would converge towards the inflation target from below more slowly than the forecast suggested. It was also said, however, that inflation expectations at the one-year horizon were close to the inflation target. An increase in government spending, which might be undertaken in an effort to mitigate the current crisis, could be an upside risk to inflation in the longer run.

The Board then discussed lending activity. It was said that lending activity was falling mainly because of lower demand for loans. It was also said that operational financing of businesses by banks was also decreasing. In this connection, concern was expressed about the potential risk of a credit crunch. Against this, it was said that banks had sufficient funds but remained cautious in the current period of uncertainty.

The Board discussed the effectiveness of transmission from monetary policy rates to the real economy. It was said that the effectiveness of the interest rate channel of transmission remained low. In this context, it was said that only a sizeable rate reduction could have an effect on the real economy. The opinion was also expressed, though, that a change in monetary policy rates would pass through to market rates gradually and that the gap between market rates and monetary policy rates had narrowed recently.

In the context of the debate of monetary policy transmission mechanisms, it was said that a change in monetary policy rates might also act via the exchange rate channel and that the exchange rate affects the economy more quickly than interest rates. It was also said, however, that the effect of monetary policy on the exchange rate was limited in the current situation. The Board agreed that the exchange rate was encumbered with considerable uncertainty, but that a weaker exchange rate would reduce the scope for lowering monetary policy rates.

At the close of the meeting the Board decided by a majority vote to lower the CNB two-week repo rate by 0.50 percentage point to 1.75%, effective 6 February 2009. At the same time it decided to lower the discount rate and Lombard rate by the same amount, to 0.75% and 2.75% respectively. Four members voted in favour of this decision: Governor Tůma, Vice-Governor Singer, Chief Executive Director Tomšík and Chief Executive Director Zamrazilová. Chief Executive Director Holman voted for lowering the rates by 0.25 percentage point and Chief Executive Director Řežábek for lowering the rates by 0.75 percentage point.



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|---------|-----------------------------------------------|--------------|---------------------------------------------|
| AEIS    | Average Earnings Information System           | IRS          | interest rate swap                          |
| ARA     | Amsterdam–Rotterdam–Antwerp                   | LFS          | Labour Force Survey                         |
| BCPP    | Prague Stock Exchange                         | Libor        | London Interbank Offered Rate               |
| ČMZRB   | Czech-Moravian Guarantee and Development Bank | M1, M2       | monetary aggregates                         |
| CNB     | Czech National Bank                           | MNB          | Hungarian National Bank                     |
| CPI     | consumer price index                          | MLSA         | Ministry of Labour and Social Affairs       |
| CZK     | Czech koruna                                  | NBP          | National Bank of Poland                     |
| CZSO    | Czech Statistical Office                      | NBS          | National Bank of Slovakia                   |
| ECB     | European Central Bank                         | NCG          | net credit to government                    |
| ECOFIN  | Council of EU ministers                       | NDAs         | net domestic assets                         |
| EIB     | European Investment Bank                      | NEAs         | net external assets                         |
| EMI     | European Monetary Institute                   | NPISHs       | non-profit institutions serving households  |
| EMS     | European Monetary System                      | OMFIs        | other monetary financial institutions       |
| ERM II  | Exchange Rate Mechanism                       | O/N          | overnight                                   |
| ESA 95  | European System of National Accounts          | PLN          | Polish zloty                                |
| EU      | European Union                                | PPI          | producer price index                        |
| EUR     | euro                                          | PRIBID       | Prague Interbank Bid Rate                   |
| EURIBOR | Euro Interbank Offered Rate                   | PRIBOR       | Prague Interbank Offered Rate               |
| FDI     | foreign direct investment                     | (1W, 1M, 1Y) | (one-week, one-month, one-year)             |
| Fed     | US central bank                               | repo rate    | repurchase agreement rate                   |
| FRA     | forward rate agreement                        | SFAOs        | state financial assets operations           |
| GDP     | gross domestic product                        | SITC         | Standard International Trade Classification |
| HICP    | Harmonised Index of Consumer Prices           | SKK          | Slovak koruna                               |
| HUF     | Hungarian forint                              | USD          | US dollar                                   |
| ILO     | International Labour Organization             | VAT          | value added tax                             |
| IMF     | International Monetary Fund                   |              |                                             |

|                                                                                                                                                                   |         |              |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------|--------------|
| 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 |
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| 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   |
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| 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)   | I/2008       |
| Publication of the forecast-consistent interest rate path and the use of fan charts                                                                                                | (Box)   | I/2008       |
| The quarterly financial accounts statistics – New statistics at the CNB                                                                                                            | (Box)   | I/2008       |
| Changes to the CNB's core prediction model                                                                                                                                         | (Box)   | I/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) | I/2008       |
| The new g3 structural model                                                                                                                                                        | (Box)   | II/2008      |
| Joint agreement between the Czech Government and the Czech National Bank and Updated strategy for dealing with the exchange rate effects of foreign exchange revenues of the state | (Annex) | II/2008      |
| The sectoral and production structure of the g3 model                                                                                                                              | (Box)   | III/2008     |
| The withdrawal of 50-heller coins and its possible impact on prices                                                                                                                | (Box)   | III/2008     |
| The impact of the still fast growing world prices of energy-producing materials on inflation in the Czech Republic                                                                 | (Box)   | IV/2008      |
| Pricing in the g3 model                                                                                                                                                            | (Box)   | IV/2008      |
| Publication of a numerical exchange rate forecast                                                                                                                                  | (Box)   | I/2009       |
| The exchange rate path in the g3 model                                                                                                                                             | (Box)   | I/2009       |
| Assessment of the fulfilment of the Maastricht convergence criteria and the degree of economic alignment of the Czech Republic with the euro area                                  | (Annex) | I/2009       |

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/en/general/glossary/index.html](http://www.cnb.cz/en/general/glossary/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 consists 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:** 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.

**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.

**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 in the Czech Republic (households, non-financial corporations and financial institutions excluding the 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.

**Net inflation:** Consumer price inflation net of regulated prices and adjusted for the first-round effects of changes to indirect taxes. Net inflation consists of food price inflation, fuel price inflation and adjusted inflation excluding fuels. Until the end of 2001, the CNB's inflation targets were set in terms of net inflation. Since 2002, the CNB has targeted headline inflation, using net inflation for analytical purposes only.

**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 inflation 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

|                                                                   |                                      | years   |         |         |         |         |         |         |         |         |         |         |
|-------------------------------------------------------------------|--------------------------------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
|                                                                   |                                      | 2000    | 2001    | 2002    | 2003    | 2004    | 2005    | 2006    | 2007    | 2008    | 2009    | 2010    |
| DEMAND AND SUPPLY                                                 |                                      |         |         |         |         |         |         |         |         |         |         |         |
| Gross domestic product                                            |                                      |         |         |         |         |         |         |         |         |         |         |         |
| GDP                                                               | CZK bn, constant p., seas. adjusted  | 2,189.7 | 2,243.4 | 2,285.9 | 2,368.2 | 2,474.2 | 2,630.6 | 2,809.4 | 2,976.6 | 3,093.5 | 3,083.7 | 3,110.5 |
| GDP                                                               | %, y-o-y, real terms, seas. adjusted | 3.7     | 2.5     | 1.9     | 3.6     | 4.5     | 6.3     | 6.8     | 5.9     | 3.9     | -0.3    | 0.9     |
| Household consumption                                             | %, y-o-y, real terms, seas. adjusted | 1.4     | 2.3     | 2.2     | 6.0     | 2.8     | 2.5     | 5.4     | 5.2     | 2.8     | 0.2     | 0.0     |
| Government consumption                                            | %, y-o-y, real terms, seas. adjusted | 0.7     | 3.6     | 6.7     | 7.1     | -3.5    | 2.9     | -0.7    | 0.4     | 2.0     | 1.5     | 0.8     |
| Gross capital formation                                           | %, y-o-y, real terms, seas. adjusted | 9.6     | 6.8     | 4.8     | -1.5    | 9.4     | -0.9    | 9.8     | 8.4     | -1.4    | -4.9    | -0.1    |
| Exports of goods and services                                     | %, y-o-y, real terms, seas. adjusted | 17.8    | 11.0    | 1.9     | 7.2     | 20.3    | 11.7    | 16.4    | 14.9    | 8.6     | -1.8    | 4.1     |
| Imports of goods and services                                     | %, y-o-y, real terms, seas. adjusted | 17.1    | 12.6    | 4.9     | 8.0     | 17.6    | 5.0     | 14.6    | 14.2    | 5.8     | -2.6    | 3.2     |
| Net exports                                                       | CZK bn, constant p., seas. adjusted  | -63.9   | -95.1   | -145.6  | -169.6  | -155.0  | -27.5   | 9.1     | 29.2    | 116.4   | 140.6   | 172.6   |
| Coincidence indicators                                            |                                      |         |         |         |         |         |         |         |         |         |         |         |
| Industrial production                                             | %, y-o-y, real terms                 | -       | 6.7     | 1.9     | 5.5     | 9.6     | 6.7     | 11.2    | 8.2     | -       | -       | -       |
| Construction output                                               | %, y-o-y, real terms                 | 5.3     | 9.6     | 2.5     | 8.9     | 9.7     | 4.2     | 6.6     | 6.7     | -       | -       | -       |
| Receipts in retail sales                                          | %, y-o-y, real terms                 | 4.3     | 4.5     | 3.0     | 4.9     | 2.5     | 4.0     | 6.5     | 7.5     | -       | -       | -       |
| PRICES                                                            |                                      |         |         |         |         |         |         |         |         |         |         |         |
| Main price indicators                                             |                                      |         |         |         |         |         |         |         |         |         |         |         |
| Inflation rate                                                    | %, end-of-period                     | 3.9     | 4.7     | 1.8     | 0.1     | 2.8     | 1.9     | 2.5     | 2.8     | 6.3     | -       | -       |
| Consumer Price Index                                              | %, y-o-y, end-of-period              | 4.0     | 4.1     | 0.6     | 1.0     | 2.8     | 2.2     | 1.7     | 5.4     | 3.6     | 0.9     | 2.2     |
| Regulated prices (16.40%)*                                        | %, y-o-y, end-of-period              | 7.3     | 11.7    | 3.3     | 1.3     | 4.4     | 9.0     | 4.9     | 6.5     | 17.1    | 3.3     | 5.0     |
| Net inflation (83.60%)*                                           | %, y-o-y, end-of-period              | 3.0     | 2.4     | -0.2    | 1.0     | 1.5     | 0.4     | 0.7     | 3.8     | -0.9    | -0.4    | 1.9     |
| Food prices (including alcoholic beverages and tobacco) (24.44%)* | %, y-o-y, end-of-period              | 3.7     | 2.9     | -3.4    | 2.7     | 0.9     | -0.7    | 0.9     | 8.2     | -2.0    | -2.9    | 1.7     |
| Adjusted inflation excluding fuels (55.12%)*                      | %, y-o-y, end-of-period              | 1.9     | 3.3     | 1.6     | 0.2     | 1.6     | 0.5     | 0.8     | 1.2     | 1.4     | 1.3     | 1.7     |
| Fuel prices (4.04%)*                                              | %, y-o-y, end-of-period              | 10.3    | -15.0   | 1.4     | -2.0    | 5.9     | 9.8     | -3.4    | 12.0    | -22.0   | -6.3    | 5.8     |
| Monetary-policy inflation (excluding tax changes)                 | %, y-o-y, end-of-period              | 4.4     | 4.2     | 0.6     | 0.8     | 1.9     | 2.2     | 1.6     | 4.3     | 1.8     | 0.9     | 2.2     |
| GDP deflator                                                      | %, y-o-y, seas. adjusted             | 1.6     | 4.9     | 2.8     | 0.9     | 4.5     | -0.2    | 1.3     | 3.9     | 0.6     | 0.3     | 1.1     |
| Partial price indicators                                          |                                      |         |         |         |         |         |         |         |         |         |         |         |
| Producer prices                                                   | %,y-o-y, average                     | 5.1     | 3.0     | -0.5    | -0.3    | 5.6     | 3.1     | 1.4     | 4.1     | 4.5     | -2.8    | 2.6     |
| Agricultural prices                                               | %,y-o-y, average                     | 8.6     | 9.6     | -7.5    | -4.5    | 9.6     | -9.8    | 1.3     | 16.4    | 5.3     | -14.6   | 3.2     |
| Construction work prices                                          | %,y-o-y, average                     | 4.1     | 4.0     | 2.7     | 2.2     | 3.7     | 3.0     | 2.9     | 3.9     | 4.5     | -       | -       |
| Brent crude oil                                                   | %, y-o-y, average                    | 71.1    | -12.7   | 4.9     | 17.6    | 33.6    | 43.2    | 21.4    | 12.3    | 40.7    | -38.6   | 21.7    |
| LABOUR MARKET                                                     |                                      |         |         |         |         |         |         |         |         |         |         |         |
| Average monthly wages in monitored organisations                  | %, y-o-y, nominal terms              | 6.4     | 8.7     | 7.3     | 6.6     | 6.6     | 5.3     | 6.5     | 7.3     | 8.2     | 4.0     | 2.7     |
| Average monthly wages in monitored organisations                  | %, y-o-y, real terms                 | 2.4     | 3.8     | 5.4     | 6.5     | 3.7     | 3.3     | 3.8     | 4.4     | 1.7     | 3.9     | 0.7     |
| Number of employees                                               | %, y-o-y                             | -1.4    | 0.3     | -0.8    | -2.0    | -0.2    | 2.2     | 1.2     | 1.9     | 1.6     | -0.9    | -1.9    |
| Nominal unit wage costs                                           | %, y-o-y                             | 1.4     | 6.2     | 4.6     | 2.3     | 1.8     | 0.6     | 1.1     | 3.1     | 4.3     | 4.8     | 2.7     |
| Nominal unit wage costs in industry                               | %, y-o-y                             | -1.8    | 0.8     | 0.2     | -3.5    | -3.2    | -3.2    | -2.9    | 0.8     | -       | -       | -       |
| Aggregate labour productivity                                     | %, y-o-y                             | 3.6     | 2.5     | 1.9     | 3.6     | 4.1     | 5.2     | 5.1     | 3.2     | 2.0     | 0.7     | 2.9     |
| ILO general unemployment rate                                     | %, average                           | -       | -       | -       | 7.8     | 8.3     | 7.9     | 7.1     | 5.3     | 4.4     | 5.0     | 6.4     |
| Registered unemployment rate                                      | %, average                           | -       | -       | -       | -       | 10.0    | 9.5     | 8.6     | 7.0     | 5.8     | 6.5     | 7.7     |
| PUBLIC FINANCE                                                    |                                      |         |         |         |         |         |         |         |         |         |         |         |
| Public finance deficit (ESA95)                                    | CZK bn, current p.                   | -81.5   | -135.0  | -166.8  | -170.0  | -82.7   | -106.6  | -85.5   | -34.2   | -38.7   | -96.7   | -128.4  |
| Public finance deficit / GDP**                                    | %, nominal terms                     | -3.7    | -5.7    | -6.8    | -6.6    | -2.9    | -3.6    | -2.7    | -1.0    | -1.0    | -2.6    | -3.3    |
| Public debt (ESA95)                                               | CZK bn, current p.                   | 405.4   | 591.5   | 702.3   | 775.0   | 855.1   | 888.6   | 951.5   | 1 020.7 | 1,067.4 | 1,156.6 | 1,258.1 |
| Public debt / GDP**                                               | %, nominal terms                     | 18.5    | 25.1    | 28.5    | 30.1    | 30.4    | 29.8    | 29.6    | 28.9    | 28.7    | 30.6    | 33.4    |
| EXTERNAL RELATIONS                                                |                                      |         |         |         |         |         |         |         |         |         |         |         |
| Current account                                                   |                                      |         |         |         |         |         |         |         |         |         |         |         |
| Trade balance                                                     | CZK bn, current p.                   | -120.8  | -116.7  | -71.3   | -69.8   | -13.4   | 59.4    | 65.1    | 120.6   | 105.1   | 100.0   | 130.0   |
| Trade balance / GDP                                               | %                                    | -5.5    | -5.0    | -2.9    | -2.7    | -0.5    | 2.0     | 2.0     | 3.4     | 2.8     | 2.6     | 3.4     |
| Balance of services                                               | CZK bn, current p.                   | 54.6    | 58.0    | 21.9    | 13.2    | 16.6    | 36.9    | 46.4    | 56.6    | 79.6    | 60.0    | 65.0    |
| Current account                                                   | CZK bn, current p.                   | -104.9  | -124.5  | -136.4  | -160.6  | -147.5  | -39.8   | -82.2   | -62.6   | -115.4  | -75.0   | -40.0   |
| Current account / GDP                                             | %                                    | -4.8    | -5.3    | -5.5    | -6.2    | -5.2    | -1.3    | -2.6    | -1.8    | -3.1    | -2.0    | -1.0    |
| Foreign direct investment                                         |                                      |         |         |         |         |         |         |         |         |         |         |         |
| Direct investment                                                 | CZK bn, current p.                   | 190.8   | 208.3   | 270.9   | 53.5    | 101.8   | 279.6   | 90.3    | 158.2   | 165.0   | 165.0   | 105.0   |
| Exchange rates                                                    |                                      |         |         |         |         |         |         |         |         |         |         |         |
| CZK/USD                                                           | average                              | 38.7    | 38.0    | 32.7    | 28.2    | 25.7    | 24.0    | 22.6    | 20.3    | 17.1    | 19.4    | 19.3    |
| CZK/EUR                                                           | average                              | 35.6    | 34.1    | 30.8    | 31.8    | 31.9    | 29.8    | 28.3    | 27.8    | 25.0    | 25.8    | 25.6    |
| CZK/EUR                                                           | %, y-o-y, real (CPI euro area), avg. | -       | -       | -       | -       | -0.7    | -6.7    | -5.6    | -2.4    | -12.9   | 3.9     | -1.6    |
| CZK/EUR                                                           | %, y-o-y, real (PPI euro area), avg. | -       | -       | -       | -       | -3.2    | -5.5    | -1.2    | -3.6    | -8.2    | 7.4     | -1.6    |
| Foreign trade prices                                              |                                      |         |         |         |         |         |         |         |         |         |         |         |
| Prices of exports of goods                                        | %, y-o-y, average                    | 6.3     | 0.4     | -6.6    | 0.8     | 3.7     | -1.5    | -1.2    | 1.4     | -4.9    | 4.8     | 2.3     |
| Prices of imports of goods                                        | %, y-o-y, average                    | 11.9    | -1.5    | -8.5    | -0.3    | 1.6     | -0.5    | 0.3     | -1.0    | -3.4    | 3.6     | 2.3     |
| MONEY AND INTEREST RATES                                          |                                      |         |         |         |         |         |         |         |         |         |         |         |
| M2                                                                | %, y-o-y, average                    | 6.4     | 11.1    | 7.0     | 4.1     | 7.7     | 5.3     | 8.9     | 11.2    | 8.3     | 5.5     | 3.5     |
| 2W repo rate                                                      | %, end-of-period                     | 5.25    | 4.75    | 2.75    | 2.00    | 2.50    | 2.00    | 2.50    | 3.50    | 2.25    | -       | -       |
| 3M PRIBOR                                                         | %, average                           | 5.4     | 5.2     | 3.5     | 2.3     | 2.3     | 2.0     | 2.3     | 3.1     | 4.0     | 2.9     | 2.6     |

\* in brackets are constant weights in actual consumer basket

\*\* CNB calculation

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

| 2006  |       |       |       | 2007  |       |       |       | 2008  |       |       |              | 2009         |              |              |              | 2010         |              |              |              |
|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| QI    | QII   | QIII  | QIV   | QI    | QII   | QIII  | QIV   | QI    | QII   | QIII  | QIV          | QI           | QII          | QIII         | QIV          | QI           | QII          | QIII         | QIV          |
| 685.7 | 697.1 | 708.1 | 718.6 | 729.8 | 739.5 | 749.1 | 758.3 | 765.6 | 773.5 | 780.7 | <b>773.7</b> | <b>771.1</b> | <b>770.9</b> | <b>773.6</b> | <b>768.1</b> | <b>774.2</b> | <b>776.4</b> | <b>781.0</b> | <b>778.9</b> |
| 6.9   | 6.9   | 6.9   | 6.6   | 6.4   | 6.1   | 5.8   | 5.5   | 4.9   | 4.6   | 4.2   | <b>2.0</b>   | <b>0.7</b>   | <b>-0.3</b>  | <b>-0.9</b>  | <b>-0.7</b>  | <b>0.4</b>   | <b>0.7</b>   | <b>1.0</b>   | <b>1.4</b>   |
| 4.8   | 5.3   | 5.2   | 6.3   | 6.1   | 5.7   | 5.5   | 3.6   | 2.7   | 3.2   | 2.5   | <b>2.9</b>   | <b>1.8</b>   | <b>0.5</b>   | <b>-0.3</b>  | <b>-1.1</b>  | <b>-0.6</b>  | <b>-0.2</b>  | <b>0.2</b>   | <b>0.7</b>   |
| 1.6   | -0.5  | -2.8  | -0.9  | 0.2   | -1.0  | 0.3   | 2.0   | 0.2   | 2.4   | 3.7   | <b>1.7</b>   | <b>2.1</b>   | <b>1.6</b>   | <b>1.0</b>   | <b>1.1</b>   | <b>1.5</b>   | <b>1.1</b>   | <b>0.5</b>   | <b>0.3</b>   |
| 11.0  | 7.9   | 11.3  | 9.0   | 11.2  | 10.3  | 7.2   | 5.3   | 4.1   | -4.0  | -2.0  | <b>-3.6</b>  | <b>-5.1</b>  | <b>-4.2</b>  | <b>-4.7</b>  | <b>-5.6</b>  | <b>-3.1</b>  | <b>-0.8</b>  | <b>1.1</b>   | <b>2.7</b>   |
| 17.7  | 16.2  | 14.1  | 17.5  | 16.4  | 14.4  | 16.2  | 12.7  | 15.3  | 13.9  | 5.0   | <b>1.1</b>   | <b>-1.6</b>  | <b>-3.3</b>  | <b>-2.2</b>  | <b>0.0</b>   | <b>2.5</b>   | <b>3.6</b>   | <b>4.6</b>   | <b>5.6</b>   |
| 16.5  | 13.5  | 11.9  | 16.6  | 16.7  | 14.1  | 15.6  | 10.7  | 12.8  | 9.7   | 1.6   | <b>-0.5</b>  | <b>-2.6</b>  | <b>-3.8</b>  | <b>-2.7</b>  | <b>-1.4</b>  | <b>1.0</b>   | <b>2.6</b>   | <b>4.1</b>   | <b>5.4</b>   |
| -1.9  | 2.7   | 2.1   | 6.2   | -3.6  | 5.2   | 7.0   | 20.6  | 14.1  | 36.1  | 33.8  | <b>32.5</b>  | <b>22.1</b>  | <b>38.4</b>  | <b>36.8</b>  | <b>43.3</b>  | <b>35.2</b>  | <b>47.6</b>  | <b>42.4</b>  | <b>47.4</b>  |
| 15.5  | 9.3   | 9.7   | 10.4  | 11.3  | 9.3   | 6.9   | 8.4   | 5.6   | 6.1   | 4.7   | -            | -            | -            | -            | -            | -            | -            | -            | -            |
| 0.5   | 6.2   | 7.4   | 9.5   | 28.8  | 3.5   | -0.3  | 5.3   | 4.0   | -1.8  | 4.9   | -            | -            | -            | -            | -            | -            | -            | -            | -            |
| 6.9   | 6.2   | 6.2   | 6.6   | 9.7   | 7.8   | 6.5   | 6.5   | 2.3   | 2.4   | 2.1   | -            | -            | -            | -            | -            | -            | -            | -            | -            |
| 2.2   | 2.5   | 2.8   | 2.5   | 2.2   | 2.1   | 2.0   | 2.8   | 4.3   | 5.4   | 6.4   | 6.3          | -            | -            | -            | -            | -            | -            | -            | -            |
| 2.8   | 2.8   | 2.7   | 1.7   | 1.9   | 2.5   | 2.8   | 5.4   | 7.1   | 6.7   | 6.6   | 3.6          | <b>1.6</b>   | <b>0.7</b>   | <b>0.2</b>   | <b>0.9</b>   | <b>1.4</b>   | <b>2.1</b>   | <b>2.3</b>   | <b>2.2</b>   |
| 11.2  | 10.5  | 9.8   | 4.9   | 4.1   | 4.0   | 4.6   | 6.5   | 15.0  | 14.7  | 15.7  | 17.1         | <b>10.8</b>  | <b>7.6</b>   | <b>5.5</b>   | <b>3.3</b>   | <b>0.5</b>   | <b>3.2</b>   | <b>4.3</b>   | <b>5.0</b>   |
| 0.1   | 0.3   | 0.5   | 0.7   | 1.3   | 1.5   | 1.2   | 3.8   | 3.5   | 2.9   | 2.9   | -0.9         | <b>-1.2</b>  | <b>-1.6</b>  | <b>-1.6</b>  | <b>-0.4</b>  | <b>1.3</b>   | <b>2.0</b>   | <b>2.0</b>   | <b>1.9</b>   |
| -1.8  | -0.6  | 1.4   | 0.9   | 3.2   | 2.7   | 2.5   | 8.2   | 4.9   | 3.0   | 3.6   | -2.0         | <b>-1.4</b>  | <b>-2.3</b>  | <b>-3.0</b>  | <b>-2.9</b>  | <b>-0.7</b>  | <b>1.7</b>   | <b>2.0</b>   | <b>1.7</b>   |
| 0.6   | 0.4   | 0.6   | 0.7   | 0.6   | 1.0   | 0.7   | 1.2   | 2.1   | 2.3   | 2.4   | 1.4          | <b>0.9</b>   | <b>0.7</b>   | <b>0.7</b>   | <b>1.3</b>   | <b>1.6</b>   | <b>1.6</b>   | <b>1.7</b>   | <b>1.7</b>   |
| 10.9  | 8.3   | -7.5  | -3.4  | -3.1  | -1.7  | -1.8  | 12.0  | 12.7  | 9.8   | 4.3   | -22.0        | <b>-26.4</b> | <b>-27.9</b> | <b>-24.4</b> | <b>-6.3</b>  | <b>11.5</b>  | <b>9.0</b>   | <b>6.9</b>   | <b>5.8</b>   |
| 2.5   | 2.5   | 2.6   | 1.3   | 1.7   | 1.9   | 1.7   | 4.3   | 5.1   | 4.6   | 4.7   | 1.8          | <b>1.0</b>   | <b>0.6</b>   | <b>0.2</b>   | <b>0.9</b>   | <b>1.4</b>   | <b>2.1</b>   | <b>2.3</b>   | <b>2.2</b>   |
| -0.4  | 0.7   | 1.6   | 1.8   | 3.5   | 3.7   | 3.5   | 3.8   | 2.5   | 1.4   | 0.9   | <b>0.8</b>   | <b>1.7</b>   | <b>0.2</b>   | <b>-0.7</b>  | <b>0.2</b>   | <b>-1.2</b>  | <b>1.5</b>   | <b>2.1</b>   | <b>2.0</b>   |
| 0.1   | 1.1   | 2.4   | 2.0   | 3.2   | 4.2   | 3.9   | 5.0   | 5.6   | 5.1   | 5.5   | 1.6          | <b>-1.8</b>  | <b>-4.0</b>  | <b>-4.3</b>  | <b>-0.9</b>  | <b>1.7</b>   | <b>3.2</b>   | <b>2.8</b>   | <b>2.5</b>   |
| -1.5  | 4.6   | 2.7   | 2.6   | 13.3  | 11.2  | 15.0  | 26.0  | 26.7  | 27.2  | 7.7   | -18.5        | <b>-23.3</b> | <b>-23.8</b> | <b>-12.9</b> | <b>1.3</b>   | <b>3.4</b>   | <b>3.2</b>   | <b>3.3</b>   | <b>3.1</b>   |
| 2.4   | 2.7   | 3.2   | 3.3   | 3.6   | 3.8   | 4.0   | 4.4   | 4.7   | 5.0   | 4.5   | 3.9          | -            | -            | -            | -            | -            | -            | -            | -            |
| 30.8  | 35.6  | 14.3  | 5.0   | -6.1  | -1.5  | 7.8   | 49.0  | 66.5  | 77.9  | 54.2  | -35.7        | <b>-52.6</b> | <b>-57.7</b> | <b>-51.4</b> | <b>7.5</b>   | <b>32.1</b>  | <b>21.7</b>  | <b>17.6</b>  | <b>15.5</b>  |
| 7.0   | 6.6   | 5.9   | 6.3   | 7.8   | 7.4   | 7.5   | 6.6   | 10.2  | 8.0   | 7.9   | <b>6.5</b>   | <b>5.2</b>   | <b>4.7</b>   | <b>3.3</b>   | <b>2.7</b>   | <b>1.9</b>   | <b>2.3</b>   | <b>3.1</b>   | <b>3.4</b>   |
| 4.1   | 3.5   | 3.0   | 4.7   | 6.1   | 4.8   | 4.8   | 1.7   | 2.7   | 1.2   | 1.2   | <b>1.8</b>   | <b>4.3</b>   | <b>4.7</b>   | <b>3.9</b>   | <b>2.6</b>   | <b>0.5</b>   | <b>0.2</b>   | <b>0.8</b>   | <b>1.2</b>   |
| 2.2   | 1.6   | 0.3   | 0.7   | 1.3   | 1.8   | 2.1   | 2.3   | 2.1   | 1.9   | 1.7   | <b>0.7</b>   | <b>0.0</b>   | <b>-0.5</b>  | <b>-1.1</b>  | <b>-1.9</b>  | <b>-2.4</b>  | <b>-2.2</b>  | <b>-1.7</b>  | <b>-1.4</b>  |
| 0.9   | 1.0   | 1.0   | 1.5   | 3.9   | 3.4   | 3.2   | 2.2   | 5.0   | 3.9   | 3.6   | <b>4.7</b>   | <b>4.8</b>   | <b>5.4</b>   | <b>5.0</b>   | <b>4.1</b>   | <b>2.4</b>   | <b>2.5</b>   | <b>2.9</b>   | <b>2.8</b>   |
| -7.2  | -1.4  | -1.8  | -3.5  | -1.3  | -0.2  | 1.3   | 0.6   | 9.5   | 4.2   | 2.5   | -            | -            | -            | -            | -            | -            | -            | -            | -            |
| 6.0   | 5.4   | 4.7   | 4.3   | 2.9   | 3.2   | 3.2   | 3.5   | 2.1   | 2.1   | 2.3   | <b>1.3</b>   | <b>0.7</b>   | <b>0.4</b>   | <b>0.5</b>   | <b>1.3</b>   | <b>3.0</b>   | <b>3.0</b>   | <b>2.7</b>   | <b>2.9</b>   |
| 8.0   | 7.1   | 7.0   | 6.5   | 6.0   | 5.3   | 5.1   | 4.8   | 4.7   | 4.2   | 4.3   | <b>4.4</b>   | <b>4.7</b>   | <b>4.7</b>   | <b>5.1</b>   | <b>5.4</b>   | <b>6.2</b>   | <b>6.2</b>   | <b>6.5</b>   | <b>6.7</b>   |
| 9.6   | 8.5   | 8.3   | 8.0   | 8.2   | 7.0   | 6.7   | 6.3   | 6.3   | 5.5   | 5.6   | 5.8          | <b>6.3</b>   | <b>6.0</b>   | <b>6.5</b>   | <b>7.0</b>   | <b>7.9</b>   | <b>7.3</b>   | <b>7.6</b>   | <b>7.9</b>   |
| -     | -     | -     | -     | -     | -     | -     | -     | -     | -     | -     | -            | -            | -            | -            | -            | -            | -            | -            | -            |
| -     | -     | -     | -     | -     | -     | -     | -     | -     | -     | -     | -            | -            | -            | -            | -            | -            | -            | -            | -            |
| -     | -     | -     | -     | -     | -     | -     | -     | -     | -     | -     | -            | -            | -            | -            | -            | -            | -            | -            | -            |
| -     | -     | -     | -     | -     | -     | -     | -     | -     | -     | -     | -            | -            | -            | -            | -            | -            | -            | -            | -            |
| 29.6  | 13.9  | 9.0   | 12.7  | 45.5  | 27.3  | 20.8  | 27.0  | 41.7  | 40.2  | 28.2  | <b>-5.0</b>  | <b>20.0</b>  | <b>25.0</b>  | <b>23.0</b>  | <b>32.0</b>  | <b>32.0</b>  | <b>31.0</b>  | <b>29.0</b>  | <b>38.0</b>  |
| 4.0   | 1.7   | 1.1   | 1.5   | 5.6   | 3.0   | 2.3   | 2.9   | 4.7   | 4.2   | 3.0   | <b>-0.5</b>  | <b>2.2</b>   | <b>2.6</b>   | <b>2.4</b>   | <b>3.4</b>   | <b>3.5</b>   | <b>3.2</b>   | <b>3.0</b>   | <b>3.9</b>   |
| 9.4   | 14.0  | 14.0  | 8.9   | 12.1  | 17.7  | 16.0  | 10.8  | 24.2  | 22.2  | 19.2  | <b>14.0</b>  | <b>17.0</b>  | <b>17.0</b>  | <b>15.0</b>  | <b>11.0</b>  | <b>19.0</b>  | <b>17.0</b>  | <b>16.0</b>  | <b>13.0</b>  |
| 21.5  | -31.5 | -28.4 | -43.8 | 28.2  | -29.9 | -35.2 | -25.8 | 28.8  | -57.7 | -31.5 | <b>-55.0</b> | <b>2.0</b>   | <b>-31.0</b> | <b>-39.0</b> | <b>-7.0</b>  | <b>16.0</b>  | <b>-25.0</b> | <b>-32.0</b> | <b>1.0</b>   |
| 2.9   | -3.9  | -3.5  | -5.2  | 3.4   | -3.3  | -3.9  | -2.8  | 3.3   | -6.1  | -3.4  | <b>-5.8</b>  | <b>0.2</b>   | <b>-3.2</b>  | <b>-4.1</b>  | <b>-0.7</b>  | <b>1.8</b>   | <b>-2.5</b>  | <b>-3.3</b>  | <b>0.1</b>   |
| 7.8   | 25.6  | 31.7  | 25.2  | 34.2  | 31.5  | 33.9  | 58.6  | 22.1  | 57.8  | 43.8  | -            | -            | -            | -            | -            | -            | -            | -            | -            |
| 23.8  | 22.6  | 22.2  | 21.7  | 21.4  | 21.0  | 20.3  | 18.5  | 17.1  | 15.9  | 16.1  | 19.2         | <b>20.0</b>  | <b>19.5</b>  | <b>19.2</b>  | <b>19.1</b>  | <b>19.1</b>  | <b>19.2</b>  | <b>19.3</b>  | <b>19.4</b>  |
| 28.6  | 28.4  | 28.3  | 28.0  | 28.0  | 28.3  | 27.9  | 26.8  | 25.5  | 24.8  | 24.1  | 25.4         | <b>26.8</b>  | <b>25.7</b>  | <b>25.4</b>  | <b>25.4</b>  | <b>25.4</b>  | <b>25.5</b>  | <b>25.7</b>  | <b>25.7</b>  |
| -5.7  | -6.7  | -5.8  | -4.4  | -1.4  | -0.7  | -1.6  | -5.9  | -12.6 | -15.0 | -16.3 | -7.8         | <b>4.7</b>   | <b>4.3</b>   | <b>6.1</b>   | <b>0.3</b>   | <b>-5.4</b>  | <b>-1.7</b>  | <b>0.1</b>   | <b>0.7</b>   |
| 0.3   | -1.3  | -1.7  | -2.3  | -2.2  | -2.4  | -3.6  | -6.0  | -9.7  | -10.9 | -11.2 | -1.2         | <b>10.9</b>  | <b>9.1</b>   | <b>8.9</b>   | <b>0.8</b>   | <b>-6.0</b>  | <b>-2.2</b>  | <b>0.5</b>   | <b>1.3</b>   |
| -1.9  | -2.3  | -0.5  | 0.0   | 1.9   | 2.8   | 1.9   | -1.2  | -4.3  | -6.2  | -6.6  | <b>-2.4</b>  | <b>1.5</b>   | <b>4.9</b>   | <b>6.7</b>   | <b>5.9</b>   | <b>3.8</b>   | <b>2.2</b>   | <b>1.5</b>   | <b>1.5</b>   |
| 1.6   | 0.6   | 0.2   | -1.4  | -1.7  | -0.4  | -0.5  | -1.5  | -3.0  | -4.4  | -4.0  | <b>-2.1</b>  | <b>1.0</b>   | <b>3.8</b>   | <b>5.0</b>   | <b>4.6</b>   | <b>3.1</b>   | <b>2.1</b>   | <b>1.8</b>   | <b>2.0</b>   |
| 8.8   | 8.3   | 9.0   | 9.6   | 10.5  | 11.6  | 11.2  | 11.7  | 10.1  | 7.6   | 8.3   | <b>7.0</b>   | <b>6.2</b>   | <b>6.0</b>   | <b>5.9</b>   | <b>3.9</b>   | <b>3.4</b>   | <b>3.2</b>   | <b>3.4</b>   | <b>3.9</b>   |
| 2.00  | 2.00  | 2.50  | 2.50  | 2.50  | 2.75  | 3.25  | 3.50  | 3.75  | 3.75  | 3.50  | 2.25         | -            | -            | -            | -            | -            | -            | -            | -            |
| 2.1   | 2.1   | 2.4   | 2.6   | 2.6   | 2.8   | 3.3   | 3.8   | 4.0   | 4.2   | 3.9   | 4.1          | <b>3.1</b>   | <b>2.8</b>   | <b>2.8</b>   | <b>2.9</b>   | <b>2.9</b>   | <b>2.6</b>   | <b>2.4</b>   | <b>2.3</b>   |

Table 2a

| INFLATION DEVELOPMENT                                      |          |       |       |       |       |       |       |       |       | annual percentage changes |       |       |
|------------------------------------------------------------|----------|-------|-------|-------|-------|-------|-------|-------|-------|---------------------------|-------|-------|
| 2006                                                       | 1        | 2     | 3     | 4     | 5     | 6     | 7     | 8     | 9     | 10                        | 11    | 12    |
| 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  |
| Net inflation                                              | 0.5      | 0.3   | 0.1   | 0.1   | 0.3   | 0.3   | 0.7   | 1.1   | 0.5   | 0.1                       | 0.2   | 0.7   |
| (contribution to consumer price inflation)                 | 0.40     | 0.23  | 0.08  | 0.09  | 0.22  | 0.24  | 0.55  | 0.88  | 0.43  | 0.06                      | 0.17  | 0.54  |
| 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  |
| Net inflation                                              | 0.7      | 0.8   | 1.3   | 1.7   | 1.6   | 1.5   | 1.1   | 0.7   | 1.2   | 2.2                       | 3.4   | 3.8   |
| (contribution to consumer price inflation)                 | 0.53     | 0.62  | 1.00  | 1.29  | 1.19  | 1.17  | 0.80  | 0.49  | 0.92  | 1.81                      | 2.84  | 3.19  |
| 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                                                       |          |       |       |       |       |       |       |       |       |                           |       |       |
| Consumer prices                                            | 7.5      | 7.5   | 7.1   | 6.8   | 6.8   | 6.7   | 6.9   | 6.5   | 6.6   | 6.0                       | 4.4   | 3.6   |
| Regulated prices                                           | 15.0     | 14.9  | 15.0  | 14.8  | 14.6  | 14.6  | 15.9  | 15.8  | 15.7  | 16.9                      | 16.8  | 17.1  |
| (contribution to consumer price inflation)                 | 2.60     | 2.59  | 2.59  | 2.56  | 2.53  | 2.52  | 2.74  | 2.72  | 2.72  | 2.93                      | 2.89  | 2.93  |
| First-round impacts of changes to indirect taxes on        |          |       |       |       |       |       |       |       |       |                           |       |       |
| consumer prices (contribution to consumer price inflation) | 2.21     | 2.07  | 2.03  | 2.12  | 2.22  | 2.19  | 2.09  | 1.85  | 1.83  | 1.82                      | 1.82  | 1.82  |
| Net inflation                                              | 3.6      | 3.8   | 3.4   | 2.9   | 2.9   | 2.9   | 2.9   | 2.7   | 2.9   | 2.0                       | 0.2   | -0.9  |
| (contribution to consumer price inflation)                 | 3.06     | 3.18  | 2.87  | 2.46  | 2.39  | 2.38  | 2.45  | 2.27  | 2.41  | 1.63                      | 0.16  | -0.71 |
| Prices of food, beverages and tobacco                      | 6.3      | 5.9   | 4.9   | 3.6   | 3.3   | 3.0   | 3.4   | 3.1   | 3.6   | 2.2                       | -1.0  | -2.0  |
| (contribution to consumer price inflation)                 | 1.66     | 1.53  | 1.28  | 0.96  | 0.89  | 0.80  | 0.90  | 0.81  | 0.94  | 0.60                      | -0.23 | -0.53 |
| Adjusted inflation excluding fuels                         | 1.6      | 1.9   | 2.0   | 2.2   | 2.2   | 2.2   | 2.2   | 2.3   | 2.4   | 2.0                       | 1.7   | 1.4   |
| (contribution to consumer price inflation)                 | 0.86     | 1.07  | 1.11  | 1.19  | 1.19  | 1.19  | 1.21  | 1.25  | 1.29  | 1.04                      | 0.89  | 0.72  |
| Fuel prices                                                | 14.5     | 15.9  | 12.7  | 8.0   | 7.6   | 9.8   | 8.3   | 5.2   | 4.3   | -0.4                      | -12.1 | -22.0 |
| (contribution to consumer price inflation)                 | 0.54     | 0.58  | 0.47  | 0.31  | 0.31  | 0.40  | 0.34  | 0.21  | 0.17  | -0.02                     | -0.49 | -0.90 |
| Monetary-policy relevant inflation                         | 5.3      | 5.4   | 5.1   | 4.7   | 4.6   | 4.5   | 4.8   | 4.7   | 4.7   | 4.2                       | 2.6   | 1.8   |
| Inflation rate (annual moving average)                     | 3.4      | 3.9   | 4.3   | 4.7   | 5.0   | 5.4   | 5.8   | 6.1   | 6.4   | 6.6                       | 6.5   | 6.3   |
| 2009                                                       | forecast |       |       |       |       |       |       |       |       |                           |       |       |
| Consumer prices                                            | 1.8      | 1.5   | 1.4   |       |       |       |       |       |       |                           |       |       |
| Regulated prices                                           | 10.9     | 10.8  | 10.8  |       |       |       |       |       |       |                           |       |       |
| (contribution to consumer price inflation)                 | 2.02     | 2.00  | 2.01  |       |       |       |       |       |       |                           |       |       |
| First-round impacts of changes to indirect taxes on        |          |       |       |       |       |       |       |       |       |                           |       |       |
| consumer prices (contribution to consumer price inflation) | 0.60     | 0.60  | 0.50  |       |       |       |       |       |       |                           |       |       |
| Net inflation                                              | -1.0     | -1.3  | -1.3  |       |       |       |       |       |       |                           |       |       |
| (contribution to consumer price inflation)                 | -0.78    | -1.05 | -1.06 |       |       |       |       |       |       |                           |       |       |
| Prices of food, beverages and tobacco                      | -1.1     | -1.5  | -1.6  |       |       |       |       |       |       |                           |       |       |
| (contribution to consumer price inflation)                 | -0.28    | -0.40 | -0.42 |       |       |       |       |       |       |                           |       |       |
| Adjusted inflation excluding fuels                         | 1.1      | 0.7   | 0.7   |       |       |       |       |       |       |                           |       |       |
| (contribution to consumer price inflation)                 | 0.57     | 0.38  | 0.37  |       |       |       |       |       |       |                           |       |       |
| Fuel prices                                                | -26.9    | -26.3 | -25.9 |       |       |       |       |       |       |                           |       |       |
| (contribution to consumer price inflation)                 | -1.07    | -1.03 | -1.02 |       |       |       |       |       |       |                           |       |       |
| Monetary-policy relevant inflation                         | 1.2      | 0.9   | 0.9   |       |       |       |       |       |       |                           |       |       |
| Inflation rate (annual moving average)                     | 5.9      | 5.4   | 4.9   |       |       |       |       |       |       |                           |       |       |

CNB calculation based on CZSO data

Table 2b

## INFLATION DEVELOPMENT

monthly percentage changes

| 2006                                                       | 1     | 2        | 3     | 4     | 5     | 6     | 7     | 8     | 9     | 10    | 11    | 12    |
|------------------------------------------------------------|-------|----------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| 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  |
| Net inflation                                              | 0.4   | -0.1     | -0.3  | 0.2   | 0.4   | 0.3   | 0.6   | 0.4   | -0.9  | -0.4  | -0.1  | 0.2   |
| (contribution to consumer price inflation)                 | 0.33  | -0.05    | -0.21 | 0.12  | 0.28  | 0.20  | 0.47  | 0.31  | -0.69 | -0.31 | -0.09 | 0.16  |
| 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  |
| Net inflation                                              | 0.4   | 0.1      | 0.2   | 0.6   | 0.3   | 0.2   | 0.2   | 0.0   | -0.4  | 0.6   | 1.1   | 0.6   |
| (contribution to consumer price inflation)                 | 0.36  | 0.05     | 0.15  | 0.46  | 0.22  | 0.16  | 0.18  | 0.03  | -0.35 | 0.49  | 0.87  | 0.47  |
| 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                                                       |       |          |       |       |       |       |       |       |       |       |       |       |
| Consumer prices                                            | 3.0   | 0.3      | -0.1  | 0.4   | 0.5   | 0.2   | 0.5   | -0.1  | -0.2  | 0.0   | -0.5  | -0.3  |
| Regulated prices                                           | 11.4  | 0.5      | 0.1   | 0.5   | 0.1   | 0.0   | 1.5   | 0.1   | 0.1   | 1.7   | 0.0   | 0.4   |
| (contribution to consumer price inflation)                 | 1.95  | 0.09     | 0.01  | 0.09  | 0.03  | 0.01  | 0.28  | 0.01  | 0.02  | 0.32  | 0.00  | 0.07  |
| First-round impacts of changes to indirect taxes on        |       |          |       |       |       |       |       |       |       |       |       |       |
| consumer prices (contribution to consumer price inflation) | 1.22  | 0.00     | 0.10  | 0.22  | 0.21  | 0.07  | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  |
| Net inflation                                              | 0.3   | 0.2      | -0.2  | 0.1   | 0.2   | 0.2   | 0.3   | -0.2  | -0.3  | -0.3  | -0.7  | -0.5  |
| (contribution to consumer price inflation)                 | 0.22  | 0.17     | -0.14 | 0.06  | 0.14  | 0.15  | 0.25  | -0.13 | -0.21 | -0.26 | -0.54 | -0.38 |
| Prices of food, beverages and tobacco                      | -0.5  | -0.3     | -0.8  | -0.3  | -0.2  | -0.2  | 0.1   | -0.4  | 0.6   | 0.2   | -0.3  | 0.1   |
| (contribution to consumer price inflation)                 | -0.13 | -0.07    | -0.21 | -0.07 | -0.06 | -0.06 | 0.04  | -0.11 | 0.15  | 0.06  | -0.09 | 0.02  |
| Adjusted inflation excluding fuels                         | 0.6   | 0.6      | 0.1   | 0.2   | 0.1   | 0.1   | 0.5   | 0.2   | -0.6  | -0.3  | -0.2  | -0.1  |
| (contribution to consumer price inflation)                 | 0.34  | 0.30     | 0.05  | 0.13  | 0.05  | 0.07  | 0.24  | 0.11  | -0.29 | -0.14 | -0.11 | -0.04 |
| Fuel prices                                                | 0.1   | -1.4     | 0.4   | 0.0   | 3.9   | 3.3   | -0.6  | -3.1  | -1.7  | -4.6  | -9.2  | -10.5 |
| (contribution to consumer price inflation)                 | 0.00  | -0.06    | 0.01  | 0.00  | 0.15  | 0.13  | -0.03 | -0.13 | -0.07 | -0.18 | -0.35 | -0.36 |
| Monetary-policy relevant inflation                         | 1.8   | 0.3      | -0.2  | 0.1   | 0.2   | 0.2   | 0.5   | -0.1  | -0.2  | 0.0   | -0.5  | -0.3  |
| 2009                                                       |       | forecast |       |       |       |       |       |       |       |       |       |       |
| Consumer prices                                            | 1.2   | 0.0      | -0.1  |       |       |       |       |       |       |       |       |       |
| Regulated prices                                           | 5.5   | 0.3      | 0.1   |       |       |       |       |       |       |       |       |       |
| (contribution to consumer price inflation)                 | 1.06  | 0.07     | 0.02  |       |       |       |       |       |       |       |       |       |
| First-round impacts of changes to indirect taxes on        |       |          |       |       |       |       |       |       |       |       |       |       |
| consumer prices (contribution to consumer price inflation) | 0.00  | 0.00     | 0.00  |       |       |       |       |       |       |       |       |       |
| Net inflation                                              | 0.2   | -0.1     | -0.2  |       |       |       |       |       |       |       |       |       |
| (contribution to consumer price inflation)                 | 0.14  | -0.11    | -0.15 |       |       |       |       |       |       |       |       |       |
| Prices of food, beverages and tobacco                      | 0.5   | -0.7     | -0.9  |       |       |       |       |       |       |       |       |       |
| (contribution to consumer price inflation)                 | 0.13  | -0.19    | -0.23 |       |       |       |       |       |       |       |       |       |
| Adjusted inflation excluding fuels                         | 0.4   | 0.2      | 0.1   |       |       |       |       |       |       |       |       |       |
| (contribution to consumer price inflation)                 | 0.21  | 0.10     | 0.05  |       |       |       |       |       |       |       |       |       |
| Fuel prices                                                | -6.3  | -0.6     | 1.0   |       |       |       |       |       |       |       |       |       |
| (contribution to consumer price inflation)                 | -0.19 | -0.02    | 0.03  |       |       |       |       |       |       |       |       |       |
| Monetary-policy relevant inflation                         | 1.2   | 0.0      | -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 |      |      |      |      |      |      |      |      |      |      |      | Average since start of year |
|-----------------------------------------------------------------------|------------------------------------|--------|------|------|------|------|------|------|------|------|------|------|------|-----------------------------|
|                                                                       |                                    | 1      | 2    | 3    | 4    | 5    | 6    | 7    | 8    | 9    | 10   | 11   | 12   |                             |
| <b>Total - 2004</b>                                                   | 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                        |
| <b>Total - 2005</b>                                                   | 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                         |
| <b>Total - 2006</b>                                                   | 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                         |
| <b>Total - 2007</b>                                                   | 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                         |
| <b>Total - 2008</b>                                                   | 1,000.0                            | 11.1   | 11.4 | 11.3 | 11.7 | 12.2 | 12.4 | 13.0 | 12.9 | 12.7 | 12.7 | 12.1 | 11.8 | 12.1                        |
| Food and non-alcoholic beverages                                      | 162.6                              | 15.5   | 14.9 | 14.5 | 15.1 | 15.9 | 15.9 | 15.4 | 13.6 | 12.9 | 12.9 | 12.9 | 12.0 | 14.2                        |
| Alcoholic beverages and tobacco                                       | 81.7                               | 18.8   | 19.0 | 18.3 | 19.1 | 19.5 | 19.7 | 21.2 | 23.3 | 26.7 | 27.5 | 28.3 | 28.4 | 22.5                        |
| Clothing and footwear                                                 | 52.4                               | -8.8   | -9.1 | -8.2 | -7.0 | -6.8 | -6.9 | -8.6 | -9.4 | -8.2 | -6.8 | -6.4 | -6.5 | -7.7                        |
| Housing, water, electricity, gas and other fuels                      | 248.3                              | 17.5   | 18.7 | 19.1 | 19.8 | 20.1 | 20.3 | 21.8 | 22.1 | 22.3 | 23.9 | 24.0 | 24.2 | 21.2                        |
| Furnishings, household equipment and routine maintenance of the house | 58.1                               | -1.2   | -1.3 | -1.1 | -0.8 | -0.7 | -0.6 | -0.6 | -0.7 | -1.1 | -1.3 | -1.3 | -1.1 | -1.0                        |
| Health                                                                | 17.9                               | 42.4   | 42.2 | 41.3 | 41.1 | 42.0 | 42.2 | 43.4 | 43.7 | 44.0 | 43.9 | 43.7 | 43.3 | 42.8                        |
| Transport                                                             | 114.1                              | 6.0    | 5.5  | 5.7  | 5.7  | 7.1  | 8.0  | 7.6  | 6.3  | 5.4  | 2.1  | -1.9 | -5.2 | 4.4                         |
| Communications                                                        | 38.7                               | 5.2    | 5.0  | 5.0  | 5.0  | 4.8  | 4.7  | 4.3  | 4.2  | 3.0  | 2.4  | 1.7  | 1.1  | 3.9                         |
| Recreation and culture                                                | 98.6                               | 2.2    | 3.2  | 2.3  | 1.8  | 1.5  | 2.0  | 4.9  | 5.7  | 1.8  | 1.4  | 0.6  | 0.6  | 2.3                         |
| Education                                                             | 6.2                                | 7.5    | 7.7  | 7.7  | 7.7  | 7.7  | 7.8  | 7.8  | 7.9  | 11.1 | 11.1 | 11.1 | 11.1 | 8.9                         |
| Hotels, cafés and restaurants                                         | 58.4                               | 10.5   | 11.5 | 11.8 | 12.3 | 12.7 | 13.1 | 13.5 | 13.5 | 14.1 | 14.3 | 14.3 | 14.3 | 13.0                        |
| Miscellaneous goods and services                                      | 63.0                               | 8.3    | 8.5  | 8.6  | 8.8  | 8.8  | 8.9  | 8.9  | 9.4  | 9.3  | 9.2  | 9.3  | 9.1  | 8.9                         |

Source: CZSO

Table 4

## CONSUMER PRICES - TRADABLES AND NONTRADABLES

annual percentage changes

|                                                           | 1    | 2    | 3    | 4    | 5    | 6    | 7    | 8    | 9    | 10    | 11    | 12    |
|-----------------------------------------------------------|------|------|------|------|------|------|------|------|------|-------|-------|-------|
| <b>2003</b>                                               |      |      |      |      |      |      |      |      |      |       |       |       |
| 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   |
| <b>2004</b>                                               |      |      |      |      |      |      |      |      |      |       |       |       |
| 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   |
| <b>2005</b>                                               |      |      |      |      |      |      |      |      |      |       |       |       |
| 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   |
| <b>2006</b>                                               |      |      |      |      |      |      |      |      |      |       |       |       |
| 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   |
| <b>2007</b>                                               |      |      |      |      |      |      |      |      |      |       |       |       |
| 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   |
| <b>2008</b>                                               |      |      |      |      |      |      |      |      |      |       |       |       |
| Fuel prices                                               | 14.5 | 15.9 | 12.7 | 8.0  | 7.6  | 9.8  | 8.3  | 5.2  | 4.3  | -0.4  | -12.1 | -22.0 |
| Other tradables excluding food and fuel prices            | -1.3 | -1.3 | -1.4 | -1.1 | -1.1 | -1.4 | -1.4 | -1.4 | -1.6 | -2.4  | -2.8  | -3.2  |
| Prices of tradables excluding regulated prices            | 4.1  | 4.6  | 4.9  | 5.0  | 5.1  | 5.2  | 5.3  | 5.4  | 5.7  | 5.5   | 5.3   | 5.0   |
| Prices of non-food commodities excluding regulated prices | 2.8  | 3.2  | 3.1  | 3.0  | 3.0  | 3.1  | 3.0  | 2.9  | 2.9  | 2.2   | 1.1   | 0.0   |
| Prices of tradables - food                                | 13.3 | 12.2 | 10.9 | 10.0 | 10.0 | 9.5  | 9.6  | 8.2  | 8.6  | 7.1   | 3.8   | 2.7   |
| Prices of nontradables - regulated prices                 | 15.0 | 14.9 | 15.0 | 14.8 | 14.6 | 14.6 | 15.9 | 15.8 | 15.7 | 16.9  | 16.8  | 17.1  |

CNB calculation based on CZSO data



Table 5

| INFLATION EXPECTATIONS OF SELECTED ECONOMIC SECTORS |                  |            |            |            | percentage changes |            |
|-----------------------------------------------------|------------------|------------|------------|------------|--------------------|------------|
|                                                     | Financial market |            | CPI        |            | Businesses         |            |
|                                                     | 1Y horizon       | 3Y horizon | 1Y horizon | 3Y horizon | 1Y horizon         | 3Y horizon |
| 1/03                                                | 2.5              | 2.7        | -          | -          | -                  | -          |
| 2/03                                                | 2.4              | 2.8        | -          | -          | -                  | -          |
| 3/03                                                | 2.5              | 2.9        | 2.1        | 2.6        | -                  | -          |
| 4/03                                                | 2.6              | 2.7        | -          | -          | -                  | -          |
| 5/03                                                | 3.7              | 2.8        | -          | -          | -                  | -          |
| 6/03                                                | 3.2              | 2.7        | 2.6        | 2.8        | -                  | -          |
| 7/03                                                | 3.3              | 2.8        | -          | -          | -                  | -          |
| 8/03                                                | 3.2              | 2.6        | -          | -          | -                  | -          |
| 9/03                                                | 3.1              | 2.7        | 2.6        | 2.6        | -                  | -          |
| 10/03                                               | 3.0              | 2.7        | -          | -          | -                  | -          |
| 11/03                                               | 3.1              | 2.7        | -          | -          | -                  | -          |
| 12/03                                               | 3.3              | 2.8        | 2.9        | 2.8        | -                  | -          |
| 1/04                                                | 2.9              | 2.9        | -          | -          | -                  | -          |
| 2/04                                                | 3.2              | 2.8        | -          | -          | -                  | -          |
| 3/04                                                | 3.0              | 2.8        | 3.3        | 3.1        | -                  | -          |
| 4/04                                                | 2.8              | 2.9        | -          | -          | -                  | -          |
| 5/04                                                | 2.6              | 2.9        | -          | -          | -                  | -          |
| 6/04                                                | 2.7              | 2.7        | 3.1        | 3.0        | -                  | -          |
| 7/04                                                | 2.8              | 2.6        | -          | -          | -                  | -          |
| 8/04                                                | 2.8              | 2.7        | -          | -          | -                  | -          |
| 9/04                                                | 3.0              | 2.9        | 3.1        | 2.7        | -                  | -          |
| 10/04                                               | 2.8              | 2.9        | -          | -          | -                  | -          |
| 11/04                                               | 2.8              | 2.7        | -          | -          | -                  | -          |
| 12/04                                               | 2.8              | 2.8        | 3.2        | 2.7        | -                  | -          |
| 1/05                                                | 2.8              | 2.7        | -          | -          | -                  | -          |
| 2/05                                                | 2.6              | 2.7        | -          | -          | -                  | -          |
| 3/05                                                | 2.6              | 2.6        | 2.7        | 2.8        | -                  | -          |
| 4/05                                                | 2.5              | 2.5        | -          | -          | -                  | -          |
| 5/05                                                | 2.4              | 2.4        | -          | -          | -                  | -          |
| 6/05                                                | 2.3              | 2.5        | 2.7        | 3.1        | -                  | -          |
| 7/05                                                | 2.4              | 2.5        | -          | -          | -                  | -          |
| 8/05                                                | 2.5              | 2.6        | -          | -          | -                  | -          |
| 9/05                                                | 2.5              | 2.5        | 2.8        | 2.8        | -                  | -          |
| 10/05                                               | 2.7              | 2.5        | -          | -          | -                  | -          |
| 11/05                                               | 2.8              | 2.6        | -          | -          | -                  | -          |
| 12/05                                               | 2.6              | 2.5        | 2.8        | 2.9        | -                  | -          |
| 1/06                                                | 2.5              | 2.4        | -          | -          | -                  | -          |
| 2/06                                                | 2.5              | 2.4        | -          | -          | -                  | -          |
| 3/06                                                | 2.5              | 2.4        | 2.7        | 2.9        | -                  | -          |
| 4/06                                                | 2.6              | 2.4        | -          | -          | -                  | -          |
| 5/06                                                | 2.6              | 2.4        | -          | -          | -                  | -          |
| 6/06                                                | 2.8              | 2.4        | 2.9        | 3.1        | -                  | -          |
| 7/06                                                | 2.9              | 2.6        | -          | -          | -                  | -          |
| 8/06                                                | 3.1              | 2.7        | -          | -          | -                  | -          |
| 9/06                                                | 3.2              | 2.7        | 3.0        | 3.2        | -                  | -          |
| 10/06                                               | 3.1              | 2.7        | -          | -          | -                  | -          |
| 11/06                                               | 3.4              | 2.7        | -          | -          | -                  | -          |
| 12/06                                               | 3.3              | 2.7        | 3.0        | 2.9        | -                  | -          |
| 1/07                                                | 3.1              | 2.6        | -          | -          | -                  | -          |
| 2/07                                                | 3.0              | 2.6        | -          | -          | -                  | -          |
| 3/07                                                | 3.2              | 2.5        | 3.0        | 3.1        | -                  | -          |
| 4/07                                                | 3.1              | 2.5        | -          | -          | -                  | -          |
| 5/07                                                | 3.2              | 2.5        | -          | -          | -                  | -          |
| 6/07                                                | 3.2              | 2.5        | 3.0        | 2.9        | -                  | -          |
| 7/07                                                | 3.1              | 2.5        | -          | -          | -                  | -          |
| 8/07                                                | 3.6              | 2.5        | -          | -          | -                  | -          |
| 9/07                                                | 4.2              | 2.5        | 3.6        | 3.4        | -                  | -          |
| 10/07                                               | 4.3              | 2.5        | -          | -          | -                  | -          |
| 11/07                                               | 4.3              | 2.6        | -          | -          | -                  | -          |
| 12/07                                               | 4.5              | 2.7        | 4.9        | 3.8        | -                  | -          |
| 1/08                                                | 3.7              | 2.8        | -          | -          | -                  | -          |
| 2/08                                                | 3.4              | 2.6        | -          | -          | -                  | -          |
| 3/08                                                | 3.2              | 2.6        | 4.9        | 3.7        | -                  | -          |
| 4/08                                                | 3.0              | 2.6        | -          | -          | -                  | -          |
| 5/08                                                | 3.1              | 2.6        | -          | -          | -                  | -          |
| 6/08                                                | 3.2              | 2.7        | 4.9        | 4.0        | -                  | -          |
| 7/08                                                | 3.1              | 2.6        | -          | -          | -                  | -          |
| 8/08                                                | 3.0              | 2.6        | -          | -          | -                  | -          |
| 9/08                                                | 2.8              | 2.6        | 4.1        | 3.8        | -                  | -          |
| 10/08                                               | 2.5              | 2.5        | -          | -          | -                  | -          |
| 11/08                                               | 2.4              | 2.5        | -          | -          | -                  | -          |
| 12/08                                               | 2.2              | 2.5        | 2.9        | 3.0        | -                  | -          |

Source: CNB statistical survey

Table 6

## HARMONISED INDEX OF CONSUMER PRICES

annual percentage changes

|                               | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|-------------------------------|------|------|------|------|------|------|
|                               | 12   | 12   | 12   | 12   | 12   | 12   |
| European Union (27 countries) | 2.1  | 2.5  | 2.3  | 2.2  | 3.2  | 2.2  |
| European Union (25 countries) | 1.9  | 2.4  | 2.1  | 2.2  | 3.1  | 2.1  |
| Belgium                       | 1.7  | 1.9  | 2.8  | 2.1  | 3.1  | 2.7  |
| Bulgaria                      | 5.6  | 4.0  | 7.4  | 6.1  | 11.6 | 7.2  |
| Czech Republic                | 0.9  | 2.5  | 1.9  | 1.5  | 5.5  | 3.3  |
| Denmark                       | 1.2  | 0.9  | 2.2  | 1.7  | 2.4  | 2.4  |
| Germany                       | 1.0  | 2.3  | 2.1  | 1.4  | 3.1  | 1.1  |
| Estonia                       | 1.2  | 4.8  | 3.6  | 5.1  | 9.7  | 7.5  |
| Ireland                       | 3.0  | 2.4  | 1.9  | 3.0  | 3.2  |      |
| Greece                        | 3.1  | 3.1  | 3.5  | 3.2  | 3.9  | 2.2  |
| Spain                         | 2.7  | 3.3  | 3.7  | 2.7  | 4.3  | 1.5  |
| France                        | 2.4  | 2.3  | 1.8  | 1.7  | 2.8  | 1.2  |
| Italy                         | 2.5  | 2.4  | 2.1  | 2.1  | 2.8  | 2.4  |
| Cyprus                        | 2.2  | 3.9  | 1.4  | 1.5  | 3.7  | 1.8  |
| Latvia                        | 3.5  | 7.4  | 7.1  | 6.8  | 14.0 | 10.4 |
| Lithuania                     | -1.3 | 2.8  | 3.0  | 4.5  | 8.2  | 8.5  |
| Luxembourg                    | 2.4  | 3.5  | 3.4  | 2.3  | 4.3  | 0.7  |
| Hungary                       | 5.6  | 5.5  | 3.3  | 6.6  | 7.4  | 3.4  |
| Malta                         | 2.4  | 1.9  | 3.4  | 0.8  | 3.1  | 5.0  |
| Netherlands                   | 1.6  | 1.2  | 2.0  | 1.7  | 1.6  | 1.7  |
| Austria                       | 1.3  | 2.5  | 1.6  | 1.6  | 3.5  | 1.5  |
| Poland                        | 1.6  | 4.4  | 0.8  | 1.4  | 4.2  | 3.3  |
| Portugal                      | 2.3  | 2.6  | 2.5  | 2.5  | 2.7  | 0.8  |
| Romania                       | 14.1 | 9.3  | 8.7  | 4.9  | 6.7  | 6.4  |
| Slovenia                      | 4.7  | 3.3  | 2.4  | 3.0  | 5.7  | 1.8  |
| Slovakia                      | 9.4  | 5.8  | 3.9  | 3.7  | 2.5  | 3.5  |
| Finland                       | 1.2  | 0.1  | 1.1  | 1.2  | 1.9  | 3.4  |
| Sweden                        | 1.8  | 0.9  | 1.3  | 1.4  | 2.5  | 2.1  |
| United Kingdom                | 1.3  | 1.7  | 1.9  | 3.0  | 2.1  |      |

Source: Eurostat

Table 7

| MONETARY SURVEY                                             |            |            |            |            |            | positions at month-ends in CZK billions |
|-------------------------------------------------------------|------------|------------|------------|------------|------------|-----------------------------------------|
|                                                             | 2003<br>12 | 2004<br>12 | 2005<br>12 | 2006<br>12 | 2007<br>12 | 2008<br>11                              |
| <b>Total assets</b>                                         | 1,766.1    | 1,844.1    | 1,992.1    | 2,188.7    | 2,478.3    | 2,572.0                                 |
| Net external assets (NEAs)                                  | 821.5      | 863.3      | 1,076.4    | 972.6      | 970.4      | 976.0                                   |
| NEAs of CNB                                                 | 687.5      | 634.1      | 724.7      | 659.1      | 633.5      | 688.2                                   |
| NEAs of OMFIs                                               | 134.0      | 229.3      | 351.7      | 313.5      | 336.9      | 287.8                                   |
| Net domestic assets                                         | 944.5      | 980.8      | 915.8      | 1,216.0    | 1,508.0    | 1,596.0                                 |
| Domestic loans                                              | 1,145.6    | 1,147.0    | 1,166.6    | 1,422.4    | 1,700.4    | 1,867.3                                 |
| Net credit to government (NCG) (including securities)       | 354.0      | 257.5      | 99.1       | 136.3      | 72.2       | -22.5                                   |
| NCG to central government (including securities)            | 408.7      | 312.4      | 163.0      | 206.9      | 146.1      | 132.2                                   |
| NCG to other government (including securities)              | -54.8      | -54.9      | -64.0      | -70.6      | -73.9      | -154.7                                  |
| Loans to corporations and households (excluding securities) | 791.6      | 889.4      | 1,067.5    | 1,286.1    | 1,628.2    | 1,889.8                                 |
| Loans to corporations (excluding securities)                | 554.1      | 574.2      | 649.7      | 745.5      | 901.9      | 1,024.5                                 |
| Loans to households (excluding securities)                  | 237.5      | 315.2      | 417.8      | 540.6      | 726.3      | 865.3                                   |
| Other net items (including securities and capital)          | -201.1     | -166.2     | -250.8     | -206.4     | -192.4     | -271.3                                  |
| Holdings of securities                                      | 16.6       | 18.8       | 14.4       | 14.0       | 26.6       | 15.2                                    |
| Issued securities                                           | -51.6      | -74.9      | -119.1     | -121.8     | -159.9     | -143.0                                  |
| <b>Liabilities</b>                                          |            |            |            |            |            |                                         |
| Monetary aggregate M2                                       | 1,766.1    | 1,844.1    | 1,992.1    | 2,188.7    | 2,478.3    | 2,572.0                                 |
| Monetary aggregate M1                                       | 902.8      | 962.3      | 1,087.3    | 1,239.8    | 1,438.7    | 1,495.8                                 |
| Currency in circulation                                     | 221.4      | 236.8      | 263.8      | 295.3      | 324.1      | 368.1                                   |
| Overnight deposits                                          | 681.4      | 725.6      | 823.5      | 944.5      | 1,114.6    | 1,127.7                                 |
| Overnight deposits - households                             | 372.1      | 410.8      | 456.6      | 529.3      | 601.2      | 707.3                                   |
| Overnight deposits - corporations                           | 309.3      | 314.7      | 367.0      | 415.3      | 513.4      | 420.5                                   |
| M2-M1 (quasi money)                                         | 863.3      | 881.8      | 904.8      | 948.9      | 1,039.7    | 1,076.2                                 |
| Deposits with agreed maturity                               | 666.4      | 675.3      | 671.4      | 674.9      | 709.8      | 663.1                                   |
| Deposits with agreed maturity - households                  | 439.8      | 458.6      | 445.1      | 433.6      | 429.0      | 368.2                                   |
| Deposits with agreed maturity - corporations                | 226.6      | 216.7      | 226.3      | 241.3      | 280.8      | 294.9                                   |
| Deposits redeemable at notice                               | 185.6      | 198.8      | 224.1      | 265.6      | 315.5      | 391.1                                   |
| Deposits redeemable at notice - households                  | 182.3      | 194.6      | 220.6      | 260.8      | 311.2      | 384.1                                   |
| Deposits redeemable at notice - corporations                | 3.2        | 4.2        | 3.6        | 4.8        | 4.3        | 7.0                                     |
| Repurchase agreements                                       | 11.3       | 7.6        | 9.3        | 8.4        | 14.4       | 22.0                                    |
| <b>Annual percentage changes</b>                            |            |            |            |            |            |                                         |
| M1                                                          | 14.6       | 6.6        | 13.0       | 14.0       | 16.0       | 8.1                                     |
| M2                                                          | 6.9        | 4.4        | 8.0        | 9.9        | 13.2       | 7.9                                     |
| Loans to corporations and households                        | 9.3        | 12.4       | 20.0       | 20.5       | 26.6       | 18.6                                    |
| M2-M1 (deposits)                                            | -0.1       | 2.1        | 2.6        | 4.9        | 9.6        | 7.5                                     |
| <b>Annual percentage growth rates</b>                       |            |            |            |            |            |                                         |
| M1                                                          | 15.5       | 8.3        | 13.1       | 14.7       | 16.6       | 8.4                                     |
| M2                                                          | 8.1        | 5.8        | 8.1        | 10.6       | 13.8       | 8.1                                     |
| Loans to corporations and households                        | 11.8       | 15.3       | 20.8       | 21.6       | 27.3       | 19.0                                    |
| M2-M1 (deposits)                                            | 1.2        | 3.3        | 2.6        | 5.7        | 10.2       | 7.6                                     |

Table 8

## MARKET INTEREST RATES

percentages; monthly averages

| A. INTEREST RATES ON INTERBANK DEPOSITS | 2003<br>12 | 2004<br>12 | 2005<br>12 | 2006<br>12 | 2007<br>12 | 2008<br>12 |
|-----------------------------------------|------------|------------|------------|------------|------------|------------|
| <b>1. Average PRIBOR <sup>1)</sup></b>  |            |            |            |            |            |            |
| - 1 day                                 | 1.98       | 2.49       | 2.00       | 2.48       | 3.40       | 2.32       |
| - 7 day                                 | 2.02       | 2.51       | 2.04       | 2.51       | 3.58       | 2.79       |
| - 14 day                                | 2.03       | 2.51       | 2.04       | 2.51       | 3.63       | 2.89       |
| - 1 month                               | 2.04       | 2.53       | 2.05       | 2.52       | 3.98       | 3.61       |
| - 2 month                               | 2.06       | 2.55       | 2.10       | 2.54       | 4.02       | 3.76       |
| - 3 month                               | 2.08       | 2.57       | 2.17       | 2.56       | 4.05       | 3.89       |
| - 6 month                               | 2.13       | 2.67       | 2.33       | 2.67       | 4.09       | 4.01       |
| - 9 month                               | 2.22       | 2.76       | 2.44       | 2.79       | 4.15       | 4.09       |
| - 12 month                              | 2.30       | 2.85       | 2.53       | 2.89       | 4.20       | 4.16       |
| <b>2. Average PRIBID <sup>1)</sup></b>  |            |            |            |            |            |            |
| - 1 day                                 | 1.88       | 2.39       | 1.90       | 2.38       | 3.30       | 2.09       |
| - 7 day                                 | 1.92       | 2.41       | 1.94       | 2.41       | 3.48       | 2.48       |
| - 14 day                                | 1.93       | 2.41       | 1.94       | 2.41       | 3.53       | 2.55       |
| - 1 month                               | 1.94       | 2.43       | 1.95       | 2.42       | 3.88       | 3.23       |
| - 2 month                               | 1.96       | 2.45       | 2.00       | 2.44       | 3.92       | 3.39       |
| - 3 month                               | 1.98       | 2.47       | 2.07       | 2.46       | 3.95       | 3.52       |
| - 6 month                               | 2.03       | 2.57       | 2.23       | 2.57       | 3.99       | 3.65       |
| - 9 month                               | 2.12       | 2.66       | 2.34       | 2.69       | 4.05       | 3.72       |
| - 12 month                              | 2.20       | 2.75       | 2.43       | 2.79       | 4.10       | 3.79       |

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

| B. FRA RATES      | 2003<br>12 | 2004<br>12 | 2005<br>12 | 2006<br>12 | 2007<br>12 | 2008<br>12 |
|-------------------|------------|------------|------------|------------|------------|------------|
| 3 * 6             | 2.23       | 2.74       | 2.46       | 2.71       | 4.15       | 3.12       |
| 3 * 9             | 2.36       | 2.81       | 2.57       | 2.83       | 4.16       | 2.98       |
| 6 * 9             | 2.47       | 2.85       | 2.66       | 2.92       | 4.15       | 2.75       |
| 6 * 12            | 2.64       | 2.92       | 2.74       | 3.02       | 4.17       | 2.71       |
| 9 * 12            | 2.77       | 2.97       | 2.79       | 3.08       | 4.16       | 2.58       |
| 9*12 - 3*6 spread | 0.55       | 0.24       | 0.33       | 0.37       | 0.02       | -0.55      |
| 6*12 - 3*9 spread | 0.28       | 0.12       | 0.17       | 0.19       | 0.02       | -0.27      |

| C. IRS RATES    | 2003<br>12 | 2004<br>12 | 2005<br>12 | 2006<br>12 | 2007<br>12 | 2008<br>12 |
|-----------------|------------|------------|------------|------------|------------|------------|
| 1Y              | 2.41       | 2.82       | 2.56       | 2.86       | 4.19       | 3.14       |
| 2Y              | 2.98       | 3.06       | 2.82       | 3.09       | 4.20       | 2.82       |
| 3Y              | 3.38       | 3.27       | 3.00       | 3.21       | 4.22       | 2.84       |
| 4Y              | 3.69       | 3.45       | 3.13       | 3.31       | 4.26       | 2.90       |
| 5Y              | 3.93       | 3.62       | 3.25       | 3.40       | 4.30       | 2.96       |
| 6Y              | 4.13       | 3.77       | 3.33       | 3.46       | 4.34       | 3.01       |
| 7Y              | 4.29       | 3.89       | 3.40       | 3.52       | 4.38       | 3.07       |
| 8Y              | 4.43       | 4.00       | 3.46       | 3.58       | 4.42       | 3.15       |
| 9Y              | 4.54       | 4.09       | 3.52       | 3.63       | 4.47       | 3.24       |
| 10Y             | 4.64       | 4.17       | 3.58       | 3.68       | 4.52       | 3.34       |
| 15Y             | 4.97       | 4.40       | 3.78       | 3.83       | 4.71       | 3.54       |
| 20Y             | 5.11       | 4.54       | 3.88       | 3.89       | 4.76       | 3.43       |
| 5Y - 1Y spread  | 1.52       | 0.80       | 0.69       | 0.54       | 0.11       | -0.18      |
| 10Y - 1Y spread | 2.23       | 1.35       | 1.02       | 0.82       | 0.33       | 0.20       |

Table 9

| NOMINAL AND REAL INTEREST RATES (ex post approach) |               |     |                              |                  |                         |      |                              |                  |                         |      |                        | percentages |
|----------------------------------------------------|---------------|-----|------------------------------|------------------|-------------------------|------|------------------------------|------------------|-------------------------|------|------------------------|-------------|
|                                                    | Nominal rates |     |                              |                  | Real rates based on CPI |      |                              |                  | Real rates based on PPI |      |                        |             |
|                                                    | PRIBOR<br>2W  | 1Y  | client rates<br>new<br>loans | time<br>deposits | PRIBOR<br>2W            | 1Y   | client rates<br>new<br>loans | time<br>deposits | PRIBOR<br>2W            | 1Y   | new<br>client<br>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 | 1.4                    |             |
| 12/07                                              | 3.6           | 4.2 | 6.9                          | 2.6              | -1.7                    | -1.1 | 1.4                          | -2.7             | -1.6                    | -1.0 | 1.5                    |             |
| 1/08                                               | 3.6           | 4.2 | 6.8                          | 2.6              | -3.7                    | -3.1 | -0.6                         | -4.6             | -2.3                    | -1.7 | 0.8                    |             |
| 2/08                                               | 3.8           | 4.1 | 7.2                          | 2.6              | -3.5                    | -3.2 | -0.3                         | -4.6             | -1.7                    | -1.4 | 1.5                    |             |
| 3/08                                               | 3.8           | 4.2 | 7.2                          | 2.6              | -3.1                    | -2.7 | 0.1                          | -4.2             | -1.4                    | -1.0 | 1.8                    |             |
| 4/08                                               | 3.8           | 4.3 | 7.2                          | 2.7              | -2.8                    | -2.4 | 0.4                          | -3.8             | -0.9                    | -0.4 | 2.4                    |             |
| 5/08                                               | 3.8           | 4.3 | 7.2                          | 2.7              | -2.8                    | -2.4 | 0.3                          | -3.9             | -1.3                    | -0.9 | 1.9                    |             |
| 6/08                                               | 3.8           | 4.4 | 6.9                          | 2.6              | -2.7                    | -2.2 | 0.2                          | -3.8             | -1.5                    | -0.9 | 1.5                    |             |
| 7/08                                               | 3.8           | 4.3 | 7.2                          | 2.7              | -2.9                    | -2.4 | 0.3                          | -3.9             | -1.4                    | -0.9 | 1.9                    |             |
| 8/08                                               | 3.6           | 3.9 | 7.1                          | 2.7              | -2.7                    | -2.4 | 0.6                          | -3.6             | -2.0                    | -1.7 | 1.4                    |             |
| 9/08                                               | 3.6           | 3.9 | 6.9                          | 2.7              | -2.8                    | -2.5 | 0.2                          | -3.7             | -1.8                    | -1.5 | 1.3                    |             |
| 10/08                                              | 3.8           | 4.3 | 7.2                          | 2.7              | -2.1                    | -1.6 | 1.1                          | -3.1             | -0.1                    | 0.4  | 3.2                    |             |
| 11/08                                              | 3.3           | 4.5 | 7.1                          | 2.4              | -1.1                    | 0.1  | 2.6                          | -1.9             | 2.1                     | 3.2  | 5.8                    |             |
| 12/08                                              | 2.9           | 4.2 | -                            | -                | -0.7                    | 0.5  | -                            | -                | 3.1                     | 4.4  | -                      |             |

Note: real rates = nominal rates deflated by annual index (CPI/PPI) in given month.

Starting from January 2004, the methodology for new loans and time deposits was changed. Newly drawn credits were replaced by newly extended loans.

Table 10

| REAL INTEREST RATES (ex ante approach) |                                          |      |           |               |  |                                   |      |           |               | percentages |
|----------------------------------------|------------------------------------------|------|-----------|---------------|--|-----------------------------------|------|-----------|---------------|-------------|
|                                        | Real rates expected by financial markets |      |           |               |  | Real rates expected by businesses |      |           |               |             |
|                                        | PRIBOR<br>2W                             | 1Y   | new loans | time deposits |  | PRIBOR<br>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 | 2.3       | -1.8          |  | -1.2                              | -0.6 | 2.0       | -2.2          | -           |
| 1/08                                   | -0.1                                     | 0.4  | 3.0       | -1.1          |  | -                                 | -    | -         | -             | -           |
| 2/08                                   | 0.3                                      | 0.7  | 3.6       | -0.8          |  | -                                 | -    | -         | -             | -           |
| 3/08                                   | 0.6                                      | 1.0  | 3.9       | -0.6          |  | -1.0                              | -0.6 | 2.2       | -2.1          | -           |
| 4/08                                   | 0.8                                      | 1.2  | 4.1       | -0.3          |  | -                                 | -    | -         | -             | -           |
| 5/08                                   | 0.7                                      | 1.1  | 3.9       | -0.4          |  | -                                 | -    | -         | -             | -           |
| 6/08                                   | 0.6                                      | 1.2  | 3.6       | -0.5          |  | -1.0                              | -0.4 | 2.0       | -2.1          | -           |
| 7/08                                   | 0.7                                      | 1.2  | 4.0       | -0.4          |  | -                                 | -    | -         | -             | -           |
| 8/08                                   | 0.6                                      | 0.9  | 4.0       | -0.3          |  | -                                 | -    | -         | -             | -           |
| 9/08                                   | 0.8                                      | 1.1  | 3.9       | -0.1          |  | -0.5                              | -0.2 | 2.6       | -1.4          | -           |
| 10/08                                  | 1.2                                      | 1.7  | 4.6       | 0.2           |  | -                                 | -    | -         | -             | -           |
| 11/08                                  | 0.9                                      | 2.0  | 4.6       | 0.0           |  | -                                 | -    | -         | -             | -           |
| 12/08                                  | 0.7                                      | 1.9  | -         | -             |  | 0.0                               | 1.3  | -         | -             | -           |

Note: real rates = nominal rates deflated by inflation expected by selected economic sectors according to the CNB statistical survey.

Starting from January 2004, the methodology for new loans and time deposits was changed. Newly drawn credits were replaced by newly extended loans.

Table 11

| KORUNA INTEREST RATES (stock of business)                                  |            |            |            |            |            | percentages |
|----------------------------------------------------------------------------|------------|------------|------------|------------|------------|-------------|
|                                                                            | 2003<br>12 | 2004<br>12 | 2005<br>12 | 2006<br>12 | 2007<br>12 | 2008<br>11  |
| <b>Koruna interest rates on loans provided by banks to residents:</b>      |            |            |            |            |            |             |
| <b>Households and non-profit institutions</b>                              |            |            |            |            |            |             |
| <b>serving households (S.14+S.15) - total</b>                              | 8.24       | 7.96       | 7.20       | 6.80       | 6.63       | 6.94        |
| - maturity up to 1 year                                                    | 11.21      | 12.82      | 12.96      | 13.75      | 13.96      | 14.60       |
| - maturity over 1 year and up to 5 years                                   | 10.17      | 12.40      | 11.43      | 11.35      | 12.46      | 13.02       |
| - maturity over 5 years                                                    | 6.65       | 6.39       | 5.96       | 5.84       | 5.79       | 6.17        |
| for consumption - total                                                    | 13.83      | 14.89      | 13.88      | 13.59      | 13.32      | 13.60       |
| - maturity up to 1 year                                                    | 14.26      | 15.48      | 16.22      | 17.31      | 17.34      | 17.80       |
| - maturity over 1 year and up to 5 years                                   | 13.86      | 15.17      | 14.94      | 14.67      | 15.13      | 15.26       |
| - maturity over 5 years                                                    | 13.21      | 13.45      | 11.85      | 11.93      | 11.65      | 12.16       |
| for house purchase - total                                                 | 6.31       | 5.93       | 5.24       | 4.91       | 4.89       | 5.16        |
| - maturity up to 1 year                                                    | 6.24       | 4.48       | 4.29       | 5.39       | 6.56       | 7.15        |
| - maturity over 1 year and up to 5 years                                   | 7.05       | 6.57       | 6.22       | 6.15       | 6.19       | 6.25        |
| - maturity over 5 years                                                    | 6.09       | 5.89       | 5.19       | 4.88       | 4.86       | 5.14        |
| other - total                                                              | 7.80       | 7.50       | 7.09       | 6.87       | 6.98       | 7.11        |
| - maturity up to 1 year                                                    | 8.49       | 8.96       | 9.09       | 9.52       | 10.35      | 10.67       |
| - maturity over 1 year and up to 5 years                                   | 8.02       | 7.63       | 7.17       | 7.74       | 8.56       | 9.14        |
| - maturity over 5 years                                                    | 7.02       | 6.58       | 5.79       | 5.51       | 5.70       | 5.98        |
| <b>Non-financial corporations (S.11) - total</b>                           | 4.53       | 4.75       | 4.20       | 4.45       | 5.52       | 5.64        |
| - maturity up to 1 year                                                    | 4.08       | 4.35       | 3.84       | 4.23       | 5.37       | 5.40        |
| - maturity over 1 year and up to 5 years                                   | 4.64       | 4.68       | 4.18       | 4.38       | 5.60       | 5.85        |
| - maturity over 5 years                                                    | 5.14       | 5.39       | 4.72       | 4.74       | 5.63       | 5.78        |
| <b>Koruna interest rates on deposits accepted by banks from residents:</b> |            |            |            |            |            |             |
| <b>Households and non-profit institutions</b>                              |            |            |            |            |            |             |
| <b>serving households (S.14+S.15) - total</b>                              | 1.30       | 1.41       | 1.25       | 1.28       | 1.41       | 1.56        |
| overnight                                                                  | 0.50       | 0.52       | 0.40       | 0.41       | 0.55       | 0.89        |
| with agreed maturity - total                                               | 2.02       | 2.13       | 1.92       | 1.96       | 2.11       | 2.18        |
| - with agreed maturity up to 2 years                                       | 0.96       | 1.37       | 1.03       | 1.49       | 2.14       | 2.31        |
| - with agreed maturity over 2 years                                        | 2.90       | 2.69       | 2.50       | 2.31       | 2.08       | 1.99        |
| redeemable at notice - total                                               | 1.26       | 1.63       | 1.71       | 1.97       | 2.14       | 2.16        |
| - redeemable at notice up to 3 months                                      | 1.67       | 2.14       | 2.27       | 2.34       | 2.42       | 2.36        |
| - redeemable at notice over 3 months                                       | 0.98       | 1.12       | 0.81       | 1.00       | 1.08       | 1.01        |
| <b>Non-financial corporations (S.11) - total</b>                           | 0.85       | 1.21       | 0.91       | 1.18       | 1.67       | 1.58        |
| overnight                                                                  | 0.64       | 0.68       | 0.52       | 0.72       | 1.06       | 0.87        |
| with agreed maturity - total                                               | 1.50       | 2.08       | 1.64       | 2.09       | 3.01       | 2.70        |
| - with agreed maturity up to 2 years                                       | 1.49       | 2.05       | 1.61       | 2.08       | 3.02       | 2.71        |
| - with agreed maturity over 2 years                                        | 3.04       | 3.12       | 2.47       | 2.28       | 2.62       | 2.09        |
| redeemable at notice - total                                               | 1.17       | 1.60       | 1.14       | 1.64       | 1.89       | 2.47        |
| - redeemable at notice up to 3 months                                      | 1.14       | 1.49       | 1.07       | 1.53       | 1.79       | 2.43        |
| - redeemable at notice over 3 months                                       | 1.32       | 2.26       | 1.64       | 2.21       | 2.93       | 3.19        |



Table 12

| BALANCE OF PAYMENTS <sup>1)</sup>                     |                |                |                |                |                |                          | in CZK millions |
|-------------------------------------------------------|----------------|----------------|----------------|----------------|----------------|--------------------------|-----------------|
|                                                       | 2003<br>Q1 - 4 | 2004<br>Q1 - 4 | 2005<br>Q1 - 4 | 2006<br>Q1 - 4 | 2007<br>Q1 - 4 | 2008 <sup>2)</sup><br>Q3 |                 |
| <b>A. Current account</b>                             | -160,614.6     | -147,455.7     | -39,826.1      | -82,245.4      | -62,613.5      | -31,517.2                |                 |
| Balance of trade                                      | -69,793.0      | -13,384.0      | 59,369.5       | 65,094.0       | 120,616.9      | 28,164.0                 |                 |
| exports                                               | 1,370,930.0    | 1,722,657.4    | 1,868,585.8    | 2,144,573.4    | 2,479,233.8    | 602,058.7                |                 |
| imports                                               | 1,440,723.0    | 1,736,041.4    | 1,809,216.3    | 2,079,479.4    | 2,358,616.9    | 573,894.7                |                 |
| Services                                              | 13,236.7       | 16,564.4       | 36,937.1       | 46,403.8       | 56,626.1       | 19,181.4                 |                 |
| credit                                                | 219,151.1      | 247,084.8      | 282,411.4      | 314,032.3      | 346,583.3      | 94,234.1                 |                 |
| transport                                             | 60,556.3       | 69,859.0       | 76,701.5       | 85,700.7       | 101,840.5      | 26,302.3                 |                 |
| travel                                                | 100,310.1      | 107,231.8      | 112,234.4      | 124,744.2      | 134,058.3      | 34,048.9                 |                 |
| others                                                | 58,284.7       | 69,994.0       | 93,475.5       | 103,587.4      | 110,684.5      | 33,882.9                 |                 |
| debit                                                 | 205,914.4      | 230,520.4      | 245,474.3      | 267,628.5      | 289,957.2      | 75,052.7                 |                 |
| transport                                             | 33,725.7       | 47,571.4       | 56,254.1       | 62,140.7       | 73,128.4       | 19,742.4                 |                 |
| travel                                                | 54,419.2       | 58,398.0       | 57,777.6       | 62,174.3       | 73,450.3       | 23,035.7                 |                 |
| others                                                | 117,769.5      | 124,551.0      | 131,442.6      | 143,313.5      | 143,378.5      | 32,274.6                 |                 |
| Income                                                | -119,858.4     | -156,637.9     | -143,427.6     | -180,853.8     | -221,674.7     | -71,773.8                |                 |
| credit                                                | 75,508.3       | 87,206.1       | 105,728.7      | 127,975.4      | 141,589.4      | 31,222.4                 |                 |
| debit                                                 | 195,366.7      | 243,844.0      | 249,156.3      | 308,829.2      | 363,264.1      | 102,996.2                |                 |
| Current transfers                                     | 15,800.1       | 6,001.8        | 7,294.9        | -12,889.4      | -18,181.8      | -7,088.8                 |                 |
| credit                                                | 46,976.7       | 53,050.6       | 76,655.5       | 56,193.1       | 69,680.1       | 14,322.6                 |                 |
| debit                                                 | 31,176.6       | 47,048.8       | 69,360.6       | 69,082.5       | 87,861.9       | 21,411.4                 |                 |
| <b>B. Capital account</b>                             | -82.2          | -14,186.5      | 4,689.3        | 8,454.6        | 19,654.8       | 1,862.6                  |                 |
| credit                                                | 198.2          | 5,608.2        | 5,525.2        | 14,269.6       | 21,273.7       | 2,473.6                  |                 |
| debit                                                 | 280.4          | 19,794.7       | 835.9          | 5,815.0        | 1,618.9        | 611.0                    |                 |
| <b>Total A + B</b>                                    | -160,696.8     | -161,642.2     | -35,136.8      | -73,790.8      | -42,958.7      | -29,654.6                |                 |
| <b>C. Financial account</b>                           | 157,093.5      | 177,312.0      | 154,767.4      | 92,417.9       | 94,413.2       | 50,373.8                 |                 |
| Direct investment                                     | 53,500.3       | 101,776.3      | 279,630.5      | 90,261.7       | 158,185.5      | 43,829.6                 |                 |
| abroad                                                | -5,815.7       | -26,067.3      | 449.0          | -33,169.6      | -27,088.9      | -6,597.6                 |                 |
| equity capital and reinvested earnings                | -3,124.6       | -20,260.0      | -4,262.8       | -33,886.7      | -16,033.2      | -5,930.7                 |                 |
| other capital                                         | -2,691.1       | -5,807.3       | 4,711.8        | 717.1          | -11,055.7      | -666.9                   |                 |
| in the Czech Republic                                 | 59,316.0       | 127,843.6      | 279,181.5      | 123,431.3      | 185,274.4      | 50,427.2                 |                 |
| equity capital and reinvested earnings                | 59,350.4       | 121,482.9      | 262,471.8      | 129,598.6      | 188,103.8      | 38,106.6                 |                 |
| other capital                                         | -34.4          | 6,360.7        | 16,709.7       | -6,167.3       | -2,829.4       | 12,320.6                 |                 |
| Portfolio investment                                  | -35,719.1      | 53,032.5       | -81,243.8      | -26,882.5      | -53,232.1      | 8,466.6                  |                 |
| assets                                                | -83,892.7      | -70,245.2      | -82,095.7      | -68,383.5      | -94,653.0      | -6,692.2                 |                 |
| equity securities                                     | 5,630.5        | -36,457.1      | -35,342.4      | -43,559.2      | -61,643.8      | -5,190.8                 |                 |
| debt securities                                       | -89,523.2      | -33,788.1      | -46,753.3      | -24,824.3      | -33,009.2      | -1,501.4                 |                 |
| liabilities                                           | 48,173.6       | 123,277.7      | 851.9          | 41,501.0       | 41,420.9       | 15,158.8                 |                 |
| equity securities                                     | 30,133.5       | 19,558.6       | -36,408.9      | 5,758.0        | -5,855.7       | -2,014.7                 |                 |
| debt securities                                       | 18,040.1       | 103,719.1      | 37,260.8       | 35,743.0       | 47,276.6       | 17,173.5                 |                 |
| Financial derivatives                                 | 3,860.1        | -3,208.0       | -2,798.6       | -6,236.9       | 1,799.6        | -                        |                 |
| assets                                                | 7,083.7        | -15,565.8      | -2,860.9       | -10,850.5      | -14,081.6      | -                        |                 |
| liabilities                                           | -3,223.6       | 12,357.8       | 62.3           | 4,613.6        | 15,881.2       | -                        |                 |
| Other investment                                      | 135,452.2      | 25,711.2       | -40,820.7      | 35,275.6       | -12,339.8      | -1,922.4                 |                 |
| assets                                                | 67,071.3       | -30,507.4      | -114,430.6     | -31,054.7      | -158,727.3     | 20,738.7                 |                 |
| long-term                                             | 1,141.3        | 20,434.2       | -16,338.0      | -6,119.2       | -47,220.2      | -9,916.7                 |                 |
| CNB                                                   | -              | -184.9         | -176.3         | -              | 2.3            | -                        |                 |
| commercial banks                                      | -999.9         | 505.0          | -24,641.7      | -10,715.8      | -45,465.8      | -9,614.3                 |                 |
| government                                            | 5,714.3        | 22,790.7       | 14,056.5       | 4,983.6        | -691.7         | -480.3                   |                 |
| other sectors                                         | -3,573.1       | -2,676.6       | -5,576.5       | -387.0         | -1,065.0       | 177.9                    |                 |
| short-term                                            | 65,930.0       | -50,941.6      | -98,092.6      | -24,935.5      | -111,507.1     | 30,655.4                 |                 |
| commercial banks                                      | 44,971.2       | -34,248.5      | -87,137.0      | 24,866.4       | -88,574.5      | 33,443.9                 |                 |
| government                                            | 2,193.8        | 92.9           | 9.4            | -              | -              | -                        |                 |
| other sectors                                         | 18,765.0       | -16,786.0      | -10,965.0      | -49,801.9      | -22,932.6      | -2,788.5                 |                 |
| liabilities                                           | 68,380.9       | 56,218.6       | 73,609.9       | 66,330.3       | 146,387.5      | -22,661.1                |                 |
| long-term                                             | 26,361.6       | 36,550.9       | 49,022.1       | 68,702.1       | 39,055.3       | 20,879.4                 |                 |
| CNB                                                   | -20.4          | -20.5          | -19.1          | -18.1          | -18.1          | -                        |                 |
| commercial banks                                      | -5,038.0       | -1,410.8       | 311.1          | 12,733.4       | 28,170.7       | 14,901.4                 |                 |
| government                                            | 10,304.7       | 10,296.1       | 20,809.1       | 9,847.3        | 2,874.0        | 6,891.1                  |                 |
| other sectors                                         | 21,115.3       | 27,686.1       | 27,921.0       | 46,139.5       | 8,028.7        | -913.1                   |                 |
| short-term                                            | 42,019.3       | 19,667.7       | 24,587.8       | -2,371.8       | 107,332.2      | -43,540.5                |                 |
| CNB                                                   | -21.4          | 843.7          | 5,060.1        | -4,147.6       | -552.8         | 528.6                    |                 |
| commercial banks                                      | 37,899.4       | -15,344.5      | 14,808.8       | 2,250.5        | 89,693.2       | -31,983.3                |                 |
| government                                            | -              | -              | -              | -              | -              | -                        |                 |
| other sectors                                         | 4,141.3        | 34,168.5       | 4,718.9        | -474.7         | 18,191.8       | -12,085.8                |                 |
| <b>Total A + B + C</b>                                | -3,603.3       | 15,669.8       | 119,630.6      | 18,627.1       | 51,454.5       | 20,719.2                 |                 |
| <b>D. Net errors and omissions, valuation changes</b> | 16,506.7       | -8,887.6       | -26,779.0      | -16,552.7      | -35,788.0      | -19,284.7                |                 |
| <b>Total A + B + C + D</b>                            | 12,903.4       | 6,782.2        | 92,851.6       | 2,074.4        | 15,666.5       | 1,434.5                  |                 |
| <b>E. Change in reserves (- increase)</b>             | -12,903.4      | -6,782.2       | -92,851.6      | -2,074.4       | -15,666.5      | -1,434.5                 |                 |

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

2) Preliminary data

Table 13

## INTERNATIONAL INVESTMENT POSITION

in CZK millions

|                                         | 2003<br>31 Dec. | 2004<br>31 Dec. | 2005<br>31 Dec. | 2006<br>31 Dec. | 2007<br>31 Dec. | 2008 <sup>1)</sup><br>30 Sep. |
|-----------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-------------------------------|
| <b>Assets</b>                           | 1,537,284.6     | 1,549,334.9     | 1,875,403.8     | 1,888,248.1     | 2,088,989.0     | 2,198,496.5                   |
| Direct investment abroad                | 58,581.5        | 84,087.4        | 88,772.7        | 104,743.3       | 126,025.0       | 136,230.0                     |
| - equity capital                        | 50,965.5        | 70,664.0        | 80,061.1        | 96,748.8        | 107,880.0       | 114,595.0                     |
| - other capital                         | 7,616.0         | 13,423.4        | 8,711.6         | 7,994.5         | 18,145.0        | 21,635.0                      |
| Portfolio investment                    | 343,968.7       | 372,237.6       | 467,808.5       | 532,163.4       | 606,406.8       | 553,255.0                     |
| - equity securities                     | 47,337.7        | 76,121.3        | 146,957.6       | 202,322.0       | 256,779.1       | 236,713.7                     |
| - debt securities                       | 296,631.0       | 296,116.3       | 320,850.9       | 329,841.4       | 349,627.7       | 316,541.3                     |
| Financial derivatives                   | 24,129.5        | 39,695.3        | 42,556.2        | 53,406.7        | 67,488.3        | 89,565.1                      |
| Other investment                        | 419,090.0       | 417,071.9       | 549,564.4       | 541,297.0       | 658,052.7       | 793,382.3                     |
| long-term                               | 157,598.6       | 118,432.7       | 136,314.1       | 128,334.6       | 163,697.5       | 208,104.1                     |
| - CNB                                   | 468.4           | 600.0           | 3,184.5         | 2,993.8         | 2,848.9         | 2,861.7                       |
| - commercial banks                      | 66,121.3        | 58,137.8        | 83,231.1        | 87,666.2        | 126,639.6       | 170,785.5                     |
| - government                            | 79,483.9        | 48,574.9        | 38,408.5        | 29,894.6        | 27,359.0        | 29,916.9                      |
| - other sectors                         | 11,525.0        | 11,120.0        | 11,490.0        | 7,780.0         | 6,850.0         | 4,540.0                       |
| short-term                              | 261,491.4       | 298,639.2       | 413,250.3       | 412,962.4       | 494,355.2       | 585,278.2                     |
| - CNB                                   | 98.8            | 71.7            | 71.1            | 131.3           | 102.1           | 76.9                          |
| - commercial banks                      | 161,150.2       | 184,588.0       | 273,879.1       | 233,831.1       | 310,703.1       | 366,441.3                     |
| of which: gold and foreign exchange     | 115,884.8       | 128,119.8       | 198,042.8       | 166,588.9       | 200,945.9       | 204,788.8                     |
| - government                            | 102.4           | 9.5             | 0.1             | -               | -               | -                             |
| - other sectors                         | 100,140.0       | 113,970.0       | 139,300.0       | 179,000.0       | 183,550.0       | 218,760.0                     |
| CNB reserves                            | 691,514.9       | 636,242.7       | 726,702.0       | 656,637.7       | 631,016.2       | 626,064.1                     |
| - gold                                  | 4,784.3         | 4,253.9         | 5,526.8         | 5,690.9         | 6,431.6         | 6,341.8                       |
| - SDR                                   | 238.7           | 118.0           | 289.8           | 346.0           | 363.3           | 362.4                         |
| - reserve position in the IMF           | 11,949.9        | 9,137.5         | 4,447.7         | 2,324.6         | 1,521.6         | 1,555.9                       |
| - foreign exchange                      | 674,451.8       | 610,659.1       | 716,315.2       | 648,192.1       | 618,048.0       | 612,942.3                     |
| - other reserve assets                  | 90.2            | 12,074.2        | 122.5           | 84.1            | 4,651.7         | 4,861.7                       |
| <b>Liabilities</b>                      | 2,064,768.3     | 2,374,328.4     | 2,710,646.3     | 2,969,225.5     | 3,329,266.4     | 3,593,055.4                   |
| Direct investment in the Czech Republic | 1,161,783.6     | 1,280,594.8     | 1,491,564.0     | 1,666,760.7     | 1,827,224.6     | 1,957,749.2                   |
| - equity capital                        | 1,009,391.8     | 1,121,842.3     | 1,316,101.8     | 1,497,465.8     | 1,665,564.6     | 1,790,164.2                   |
| - other capital                         | 152,391.8       | 158,752.5       | 175,462.2       | 169,294.9       | 161,660.0       | 167,585.0                     |
| Portfolio investment                    | 223,620.4       | 381,019.4       | 437,806.0       | 487,994.5       | 556,342.4       | 572,179.0                     |
| - equity securities                     | 140,788.6       | 208,872.1       | 220,495.8       | 241,594.8       | 262,518.8       | 217,266.0                     |
| - debt securities                       | 82,831.8        | 172,147.3       | 217,310.2       | 246,399.7       | 293,823.6       | 354,913.0                     |
| Financial derivatives                   | 19,448.3        | 31,806.1        | 31,868.4        | 36,482.0        | 52,363.2        | 72,262.6                      |
| Other investment                        | 659,916.0       | 680,908.1       | 749,407.9       | 777,988.3       | 893,336.2       | 990,864.6                     |
| long-term                               | 360,279.2       | 373,456.4       | 417,645.7       | 464,073.2       | 485,570.5       | 514,433.1                     |
| - CNB                                   | 96.1            | 70.2            | 47.8            | 27.2            | 8.8             | -                             |
| - commercial banks                      | 58,056.3        | 52,020.8        | 51,639.8        | 62,263.6        | 87,448.8        | 112,893.1                     |
| - government                            | 22,456.0        | 32,065.4        | 52,322.1        | 61,686.4        | 64,197.4        | 69,984.5                      |
| - other sectors                         | 279,670.8       | 289,300.0       | 313,636.0       | 340,096.0       | 333,915.5       | 331,555.5                     |
| short-term                              | 299,636.8       | 307,451.7       | 331,762.2       | 313,915.1       | 407,765.7       | 476,431.5                     |
| - CNB                                   | 22.8            | 866.5           | 5,926.5         | 1,779.0         | 1,226.2         | 745.4                         |
| - commercial banks                      | 208,534.0       | 185,025.2       | 201,315.7       | 193,816.1       | 272,729.5       | 330,386.1                     |
| - government                            | -               | -               | -               | -               | -               | -                             |
| - other sectors                         | 91,080.0        | 121,560.0       | 124,520.0       | 118,320.0       | 133,810.0       | 145,300.0                     |
| <b>Net investment position</b>          | -527,483.7      | -824,993.5      | -835,242.5      | -1,080,977.4    | -1,240,277.4    | -1,394,558.9                  |

1) Preliminary data

Table 14

| EXTERNAL DEBT                                                                                                        |                 |                 |                 |                 |                 | in CZK millions               |
|----------------------------------------------------------------------------------------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-------------------------------|
|                                                                                                                      | 2003<br>31 Dec. | 2004<br>31 Dec. | 2005<br>31 Dec. | 2006<br>31 Dec. | 2007<br>31 Dec. | 2008 <sup>1)</sup><br>30 Sep. |
| <b>Debt in convertible currencies</b>                                                                                | 895,139.6       | 1,011,807.9     | 1,142,180.3     | 1,193,682.9     | 1,348,819.8     | 1,513,362.6                   |
| of which:                                                                                                            |                 |                 |                 |                 |                 |                               |
| Long-term                                                                                                            | 535,995.9       | 667,327.6       | 783,533.1       | 872,113.2       | 926,756.3       | 1,001,343.5                   |
| by debtor                                                                                                            |                 |                 |                 |                 |                 |                               |
| - CNB                                                                                                                | 96.1            | 70.2            | 47.8            | 27.2            | 8.8             |                               |
| - commercial banks                                                                                                   | 73,276.4        | 64,346.5        | 65,418.9        | 76,426.6        | 107,852.7       | 139,212.8                     |
| - government                                                                                                         | 69,029.9        | 147,729.1       | 221,003.4       | 247,019.8       | 266,992.2       | 322,166.6                     |
| - other sectors                                                                                                      | 393,593.5       | 455,181.8       | 497,063.0       | 548,639.6       | 551,902.6       | 539,964.1                     |
| by creditor                                                                                                          |                 |                 |                 |                 |                 |                               |
| - foreign banks                                                                                                      | 251,535.3       | 269,081.3       | 276,594.3       | 324,908.9       | 348,801.1       | 361,225.4                     |
| - government institutions                                                                                            | -               | -               | 9,636.0         | 9,555.5         | 8,686.0         | 7,249.6                       |
| - multilateral institutions                                                                                          | 83,779.6        | 84,862.4        | 105,187.7       | 107,043.6       | 99,219.6        | 114,665.5                     |
| - suppliers and direct investors                                                                                     | 109,287.9       | 143,301.2       | 170,586.6       | 179,903.7       | 173,410.0       | 154,635.0                     |
| - other investors                                                                                                    | 91,393.1        | 170,082.7       | 221,528.5       | 250,701.5       | 296,639.6       | 363,568.0                     |
| Short-term                                                                                                           | 359,143.7       | 344,480.3       | 358,647.2       | 321,569.7       | 422,063.5       | 512,019.1                     |
| by debtor                                                                                                            |                 |                 |                 |                 |                 |                               |
| - CNB                                                                                                                | 22.8            | 866.5           | 5,926.5         | 1,779.0         | 1,226.2         | 745.4                         |
| - commercial banks                                                                                                   | 210,017.0       | 188,495.9       | 202,616.9       | 196,529.5       | 274,731.5       | 335,251.3                     |
| - government                                                                                                         | 710.0           | 3,334.6         | 1,102.4         | 350.0           | 5,722.8         | 324.0                         |
| - other sectors                                                                                                      | 148,393.9       | 151,783.3       | 149,001.4       | 122,911.2       | 140,383.0       | 175,698.4                     |
| by creditor                                                                                                          |                 |                 |                 |                 |                 |                               |
| - foreign banks                                                                                                      | 218,436.1       | 202,372.6       | 197,820.7       | 187,186.7       | 240,864.7       | 299,619.9                     |
| - multilateral institutions                                                                                          | -               | 861.3           | 5,918.8         | 1,768.2         | 1,220.3         | 741.7                         |
| - suppliers and direct investors                                                                                     | 105,563.9       | 98,611.3        | 102,235.6       | 78,391.2        | 88,700.0        | 116,020.0                     |
| - other investors                                                                                                    | 35,143.7        | 42,635.1        | 52,672.1        | 54,223.6        | 91,278.5        | 95,637.5                      |
| <b>Debt in non-convertible currencies</b>                                                                            | -               | -               | -               | -               | -               | -                             |
| of which:                                                                                                            |                 |                 |                 |                 |                 |                               |
| - long-term                                                                                                          | -               | -               | -               | -               | -               | -                             |
| - short-term                                                                                                         | -               | -               | -               | -               | -               | -                             |
| <b>Total external debt</b>                                                                                           | 895,139.6       | 1,011,807.9     | 1,142,180.3     | 1,193,682.9     | 1,348,819.8     | 1,513,362.6                   |
| of which:                                                                                                            |                 |                 |                 |                 |                 |                               |
| - long-term                                                                                                          | 535,995.9       | 667,327.6       | 783,533.1       | 872,113.2       | 926,756.3       | 1,001,343.5                   |
| - short-term                                                                                                         | 359,143.7       | 344,480.3       | 358,647.2       | 321,569.7       | 422,063.5       | 512,019.1                     |
| <b>Total long-term debt</b>                                                                                          | 535,995.9       | 667,327.6       | 783,533.1       | 872,113.2       | 926,756.3       | 1,001,343.5                   |
| 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       | 342,241.9       | 375,189.8       | 452,641.2                     |
| - liabilities of entities with majority private capital                                                              | 313,875.0       | 395,125.5       | 461,034.7       | 529,871.3       | 551,566.5       | 548,702.3                     |

1) Preliminary data

Table 15

## FOREIGN EXCHANGE AND CAPITAL MARKETS

in CZK; foreign exchange market rates

| A. NOMINAL RATE                                      | 2003<br>1 – 12 | 2004<br>1 – 12 | 2005<br>1 – 12 | 2006<br>1 – 12 | 2007<br>1 – 12 | 2008<br>10 – 12 |
|------------------------------------------------------|----------------|----------------|----------------|----------------|----------------|-----------------|
| <b>CZK exchange rate against selected currencies</b> |                |                |                |                |                |                 |
| - annual/quarterly averages                          |                |                |                |                |                |                 |
| 1 EUR                                                | 31.84          | 31.90          | 29.78          | 28.34          | 27.76          | 25.34           |
| 1 USD                                                | 28.23          | 25.70          | 23.95          | 22.61          | 20.31          | 19.25           |
| 100 SKK                                              | 76.75          | 79.69          | 77.15          | 76.16          | 82.20          | 83.51           |
|                                                      | <b>12</b>      | <b>12</b>      | <b>12</b>      | <b>12</b>      | <b>12</b>      | <b>12</b>       |
| - monthly averages                                   |                |                |                |                |                |                 |
| 1 EUR                                                | 32.31          | 30.65          | 28.98          | 27.78          | 26.30          | 26.11           |
| 1 USD                                                | 26.32          | 22.87          | 24.44          | 21.02          | 18.04          | 19.48           |
| 100 SKK                                              | 78.57          | 78.81          | 76.51          | 79.44          | 78.77          | 86.46           |
|                                                      | <b>31 Dec.</b> | <b>31 Dec.</b> | <b>30 Dec.</b> | <b>29 Dec.</b> | <b>31 Dec.</b> | <b>31 Dec.</b>  |
| - last day of the month                              |                |                |                |                |                |                 |
| 1 EUR                                                | 32.41          | 30.47          | 29.01          | 27.50          | 26.62          | 26.93           |
| 1 USD                                                | 25.65          | 22.37          | 24.59          | 20.88          | 18.08          | 19.35           |
| 100 SKK                                              | 78.71          | 78.63          | 76.57          | 79.86          | 79.18          | 89.34           |

| B. NOMINAL EFFECTIVE RATE                                       | 2003  | 2004  | 2005   | 2006   | 2007   | 2008<br>12 |
|-----------------------------------------------------------------|-------|-------|--------|--------|--------|------------|
| CZK nominal effective exchange rate (percentages)<br>(2005=100) |       |       |        |        |        |            |
| weights - foreign trade turnover                                | 93.97 | 94.34 | 100.00 | 104.78 | 106.64 | 113.60     |
| weights - foreign trade turnover SITC 5-8                       | 93.82 | 94.19 | 100.00 | 104.96 | 106.98 | 113.87     |

Drawing on CZSO statistics on the geographical and commodity structure of foreign trade for 2005, 26 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   | 2008<br>11 |
|--------------------------------------------------------------|-------|-------|--------|--------|--------|------------|
| CZK real effective exchange rate (percentages)<br>(2005=100) |       |       |        |        |        |            |
| a) industrial producer prices                                |       |       |        |        |        |            |
| weights - foreign trade turnover                             | 92.96 | 95.71 | 100.00 | 102.07 | 104.48 | 110.94     |
| weights - foreign trade turnover SITC 5-8                    | 92.43 | 95.40 | 100.00 | 102.38 | 105.02 | 111.95     |
| b) consumer prices                                           |       |       |        |        |        |            |
| weights - foreign trade turnover                             | 95.28 | 95.28 | 100.00 | 104.33 | 106.89 | 118.44     |
| weights - foreign trade turnover SITC 5-8                    | 94.61 | 94.89 | 100.00 | 104.73 | 107.57 | 119.80     |

Source: CZSO - consumer prices and industrial producer prices of the Czech Republic

Monthly IMF publication - International Financial Statistics - and the CNB's own calculations

| D. STOCK MARKET INDICES | 2003<br>12 | 2004<br>12 | 2005<br>12 | 2006<br>12 | 2007<br>12 | 2008<br>12 |
|-------------------------|------------|------------|------------|------------|------------|------------|
| <b>BCPP</b>             |            |            |            |            |            |            |
| PX                      | 659.1      | 1 032.0    | 1 473.0    | 1 588.9    | 1 815.1    | 858.2      |
| PX-GLOB                 | 816.9      | 1 232.7    | 1 811.3    | 1 987.4    | 2 268.4    | 1 096.4    |

last days of months in points

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.

Table 16

## CNB MONETARY POLICY INSTRUMENTS

rate valid from relevant date

|              | 2W repo<br>rate<br>(%) | Discount<br>rate<br>(%) | Lombard<br>rate<br>(%) | Minimum reserve requirement<br>for primary deposits (%) |                                    |
|--------------|------------------------|-------------------------|------------------------|---------------------------------------------------------|------------------------------------|
|              |                        |                         |                        | Banks                                                   | Building<br>societies<br>and ČMZRB |
| <b>1999</b>  |                        |                         |                        |                                                         |                                    |
| 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                   | -                       | -                      | -                                                       | -                                  |
| <b>2000</b>  |                        |                         | No changes made        |                                                         |                                    |
| <b>2001</b>  |                        |                         |                        |                                                         |                                    |
| 23 February  | 5.00                   | 4.00                    | 6.00                   | -                                                       | -                                  |
| 27 July      | 5.25                   | 4.25                    | 6.25                   | -                                                       | -                                  |
| 30 November  | 4.75                   | 3.75                    | 5.75                   | -                                                       | -                                  |
| <b>2002</b>  |                        |                         |                        |                                                         |                                    |
| 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                   | -                                                       | -                                  |
| <b>2003</b>  |                        |                         |                        |                                                         |                                    |
| 31 January   | 2.50                   | 1.50                    | 3.50                   | -                                                       | -                                  |
| 26 June      | 2.25                   | 1.25                    | 3.25                   | -                                                       | -                                  |
| 1 August     | 2.00                   | 1.00                    | 3.00                   | -                                                       | -                                  |
| <b>2004</b>  |                        |                         |                        |                                                         |                                    |
| 25 June      | 2.25                   | 1.25                    | 3.25                   | -                                                       | -                                  |
| 27 August    | 2.50                   | 1.50                    | 3.50                   | -                                                       | -                                  |
| <b>2005</b>  |                        |                         |                        |                                                         |                                    |
| 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                   | -                                                       | -                                  |
| <b>2006</b>  |                        |                         |                        |                                                         |                                    |
| 28 July      | 2.25                   | 1.25                    | 3.25                   | -                                                       | -                                  |
| 29 September | 2.50                   | 1.50                    | 3.50                   | -                                                       | -                                  |
| <b>2007</b>  |                        |                         |                        |                                                         |                                    |
| 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                   | -                                                       | -                                  |
| <b>2008</b>  |                        |                         |                        |                                                         |                                    |
| 8 February   | 3.75                   | 2.75                    | 4.75                   | -                                                       | -                                  |
| 8 August     | 3.50                   | 2.50                    | 4.50                   | -                                                       | -                                  |
| 7 November   | 2.75                   | 1.75                    | 3.75                   | -                                                       | -                                  |
| 18 December  | 2.25                   | 1.25                    | 3.25                   | -                                                       | -                                  |

Table 17

| MACROECONOMIC AGGREGATES                                         |           |           |           |           |           |         |
|------------------------------------------------------------------|-----------|-----------|-----------|-----------|-----------|---------|
|                                                                  | 2003      | 2004      | 2005      | 2006      | 2007      | 2008    |
|                                                                  | Q1 - 4    | Q1 - 4    | Q1 - 4    | Q1 - 4    | Q1 - 4    | Q3      |
| in CZK millions; annual percentage changes; constant 2000 prices |           |           |           |           |           |         |
| <b>Gross domestic product</b>                                    |           |           |           |           |           |         |
| - in CZK millions                                                | 2,367,818 | 2,474,006 | 2,630,273 | 2,808,784 | 2,975,921 | 783,604 |
| - percentages                                                    | 3.6       | 4.5       | 6.3       | 6.8       | 6.0       | 4.3     |
| <b>Final consumption</b>                                         |           |           |           |           |           |         |
| - in CZK millions                                                | 1,817,625 | 1,834,457 | 1,882,570 | 1,949,121 | 2,023,370 | 521,829 |
| - percentages                                                    | 6.3       | 0.9       | 2.6       | 3.5       | 3.8       | 2.9     |
| of which:                                                        |           |           |           |           |           |         |
| Households                                                       |           |           |           |           |           |         |
| - in CZK millions                                                | 1,258,158 | 1,294,377 | 1,327,217 | 1,398,284 | 1,471,246 | 386,580 |
| - percentages                                                    | 6.0       | 2.9       | 2.5       | 5.4       | 5.2       | 2.8     |
| Government                                                       |           |           |           |           |           |         |
| - in CZK millions                                                | 545,999   | 526,656   | 541,825   | 538,094   | 540,037   | 133,529 |
| - percentages                                                    | 7.1       | -3.5      | 2.9       | -0.7      | 0.4       | 3.5     |
| Non-profit institutions                                          |           |           |           |           |           |         |
| - in CZK millions                                                | 13,362    | 14,579    | 14,629    | 16,195    | 18,042    | 4,361   |
| - percentages                                                    | 6.2       | 9.1       | 0.3       | 10.7      | 11.4      | -3.4    |
| <b>Gross capital formation</b>                                   |           |           |           |           |           |         |
| - in CZK millions                                                | 709,600   | 773,916   | 767,420   | 847,801   | 919,395   | 229,586 |
| - percentages                                                    | -1.4      | 9.1       | -0.8      | 10.5      | 8.4       | -5.7    |
| of which:                                                        |           |           |           |           |           |         |
| Fixed capital                                                    |           |           |           |           |           |         |
| - in CZK millions                                                | 689,117   | 716,285   | 729,043   | 776,498   | 828,316   | 219,082 |
| - percentages                                                    | 0.4       | 3.9       | 1.8       | 6.5       | 6.7       | 4.5     |
| Changes in inventories                                           |           |           |           |           |           |         |
| - in CZK millions                                                | 15,642    | 54,706    | 35,654    | 68,587    | 88,179    | 9,771   |
| Acquisitions less disposals of valuables                         |           |           |           |           |           |         |
| - in CZK millions                                                | 4,841     | 2,925     | 2,723     | 2,716     | 2,900     | 733     |
| - percentages                                                    | 40.8      | -39.6     | -6.9      | -0.2      | 6.7       | -0.1    |
| <b>Foreign trade</b>                                             |           |           |           |           |           |         |
| of which:                                                        |           |           |           |           |           |         |
| Exports of goods                                                 |           |           |           |           |           |         |
| - in CZK millions                                                | 1,479,795 | 1,820,657 | 2,032,500 | 2,369,984 | 2,742,708 | 719,080 |
| - percentages                                                    | 9.3       | 23.0      | 11.6      | 16.6      | 15.7      | 8.5     |
| Exports of services                                              |           |           |           |           |           |         |
| - in CZK millions                                                | 212,807   | 226,614   | 251,989   | 278,317   | 305,037   | 90,166  |
| - percentages                                                    | -4.2      | 6.5       | 11.2      | 10.4      | 9.6       | 11.0    |
| Imports of goods                                                 |           |           |           |           |           |         |
| - in CZK millions                                                | 1,623,393 | 1,928,984 | 2,033,055 | 2,333,268 | 2,683,031 | 679,820 |
| - percentages                                                    | 9.0       | 18.8      | 5.4       | 14.8      | 15.0      | 3.6     |
| Imports of services                                              |           |           |           |           |           |         |
| - in CZK millions                                                | 235,915   | 263,438   | 268,334   | 295,936   | 320,412   | 91,054  |
| - percentages                                                    | 1.8       | 11.7      | 1.9       | 10.3      | 8.3       | 7.4     |
| <b>Final domestic demand</b>                                     |           |           |           |           |           |         |
| - in CZK millions                                                | 2,506,742 | 2,550,742 | 2,611,613 | 2,725,619 | 2,851,686 | 740,911 |
| - percentages                                                    | 4.6       | 1.8       | 2.4       | 4.4       | 4.6       | 3.4     |
| <b>Aggregate domestic demand</b>                                 |           |           |           |           |           |         |
| - in CZK millions                                                | 2,527,225 | 2,608,373 | 2,649,990 | 2,796,922 | 2,942,765 | 751,415 |
| - percentages                                                    | 4.0       | 3.2       | 1.6       | 5.5       | 5.2       | 0.1     |
| <b>Gross domestic product at current prices</b>                  |           |           |           |           |           |         |
| - in CZK millions                                                | 2,577,110 | 2,814,762 | 2,983,862 | 3,215,642 | 3,530,249 | 940,796 |
| - percentages                                                    | 4.6       | 9.2       | 6.0       | 7.8       | 9.8       | 5.3     |

Source: CZSO

|          |                                                     |    |
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